SEC FILE NO 2-27473 10 SIC 531 D 67 40 00 000

DIVERSIFIED RETAILING CO INC

10-K

OTHER

CARD 1

FOR 01/31/76

Diversified Retailing Company, Inc. [Md.] Co: D674000000
1300 Mercentile Bank & Trust Building
2 Hopkins Plaza
Baltimore, Md. 21201
SEC File No: 2-27473 Exch: Other
IRS No: 52-0846159 CUSIP: 2553279
Fiscal Year Ends: 1/31 SIC No: 531
10-Q For: 11/2/74

Diversified Retailing Company, Inc. [Md.] Co: D674000000
1300 Mercentile Bank & Trust Building
2 Hopkins Plaza
Baltimore, Md. 21201
SEC File No: 2-27473 Exch: Other
IRS No: 52-0846159 CUSIP: 2553279
Fiscal Year Ends: 1/31 SIC No: 531
Auditor: Peat, Marwick, Mitchell & Co.

10-K For: 2/1/75
Auditor: Ernst & Ernst
Shareholders: 280

For the years ended:	2/1/75	2/2/74
Revenues:	$34,924,966	$38,398,636
Earnings:	$1,843,037/$1.84	$2,982,254/$2.98
Extr. Items:	$68,391	$395,578
Assets:	$39,468,919	$34,183,741
Net Worth:	$22,745,786	$20,902,749

Description of Business: Operates chain of retail stores selling women's and children's apparel in ten states. Writes fire and casualty insurance and reinsurance and workmen's compensation insurance.

- Womens apparel retailing; Childrens apparel retailing; Chain store operation

Auditor's Report:

- Qualified opinions for uncertainties; Common stock investments; Civil court proceedings; Proposed divestiture; Regulatory orders; Consent decrees; Proposed spinoff
- Qualified opinions for uncertainties; Common stock investments; Civil court proceedings; Class action; Sales taxes; Rescission
- Qualified opinions for uncertainties; Common stock investments; Civil court proceedings; Class action; Private placement; Stock offering; Appealed court cases
- Qualified opinions for consistency; Reporting entity changes; Consolidated insurance subsidiaries

Financial Statements and Notes:

- Leased department sales (revenue); Included in sales
- Negative goodwill; Goodwill amortized under 40 years
- Subsidiary fiscal year variations; Consolidated insurance subsidiaries; *12/31
- Accounting estimate changes; Useful life; Goodwill; Supplementary income information
- Unusual effective tax rate; Tax exempt bond interest
- Unusual effective tax rate; Capital gains taxes
- Unusual effective tax rate; Tax timing differences
- Unusual effective tax rate; Dividends received deductions (IRC)
- Extraordinary gains; Condemnation; Forced asset disposal

Exhibits: None indexed

10-Q For: 5/3/75
10-Q For: 8/2/75
10-Q For: 11/1/75
8-K For: 12/31/75

145

D 674 000

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended
January 31, 1976

Commission file number:
2-27473

DIVERSIFIED RETAILERS COMPANY, INC.

State of Incorporation: Maryland

I.R.S. Employer Identification No.: 52-0846139

Address of Principal Executive Offices:
1330 Mercantile Bank and Trust Building
2 Hopkins Plaza
Baltimore, Maryland 21201

Registrant's Telephone Number, Including Area Code:
(301) 547-0500

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO ____

PART I

ITEM 1. BUSINESS

A. General

Diversified Retailing Company, Inc. (hereinafter referred to as the "Company"), a Maryland corporation, is a holding company which renders financial and operating advice to its wholly-owned subsidiary, Associated Retail Stores, Inc. (hereinafter referred to as "Associated") and to Associated's subsidiary. The Company also owns shares of Berkshire Hathaway Inc. (hereinafter referred to as "Berkshire"); a subsidiary of Associated's also owns shares of Berkshire.

The Company has no direct salaried employees and (with certain nominal exceptions noted under ITEM 12. DIRECTORS OF REGISTRANT and/or under ITEM 13. REMUNERATION OF DIRECTORS AND OFFICERS) does not compensate its Directors and Officers for their services. The Company's President, Robert M. Goldman, acts upon material corporate matters only with the approval of the Board of Directors of the Company.

B. Associated Retail Stores, Inc.

Associated, an Illinois corporation, is the Company's wholly-owned subsidiary. Associated operates a chain of stores which sell at retail popularly priced women's and, in a number of stores, children's apparel. The stores are located in downtown, neighborhood and shopping center retail areas of principal cities in ten (10) states, in leased or owned premises (see ITEM 3. PROPERTIES), and operate under various trade names.

NOTE: Unless the text otherwise indicated, all statements made in PART I describe circumstances existing as of January 31, 1976.

Associated seeks to afford its customers a wide variety of available merchandise while reducing its overhead costs to as low a level as is possible. Because of the number of stores operated by Associated, it is able to practice certain economies of scale. All of Associated's stores are served by a central buying and warehousing organization located in New York City, from which the stores' apparel lines are administered. A staff of merchandise managers and buyers maintains daily personal contact with the apparel markets located in New York City and elsewhere. Nearly all receiving and purchasing activities are conducted in the central warehouse, from which shipments are made daily to the various stores. Associated utilizes detailed inventory control and analysis procedures, primarily through the use of an owned computer system, to identify popular and fast-selling items for rapid replacement, and to identify those items requiring an immediate reduction in price so that they may be sold quickly. In addition, Associated utilizes interchangeable store fixtures to facilitate the opening and closing of its stores. Associated's policy of making sales only for cash or on credit under approved bank charge account plans has allowed it further to avoid unnecessary overhead costs.

Associated regularly employs approximately one thousand, three hundred fifty (1,350) full and part-time employees, and seasonally employs an additional one hundred fifty (150) employees. All of its sales personnel are paid at an hourly rate, and none are paid sales commissions. Approximately eighty percent (80%) of Associated's employees are covered by union contracts which expire at various times. There were no significant changes in employee relations during the fiscal year ended January 31, 1976, and

Associated's management considers its relations with its employees to be satisfactory.

The business of most of the stores, particularly those in the larger cities, involves intense competition with other stores selling similar merchandise, including discount and department stores, specialty shops and stores operated by national chains.

In addition to operating the chain of retail stores, Associated wholly-owns one (1) subsidiary,* and that subsidiary owns 99.6% of another company.

(1) Columbia Insurance Company

Columbia Insurance Company** (hereinafter referred to as "Columbia"), a Nebraska corporation, is a wholly-owned subsidiary of Associated which engages in the business of fire and casualty insurance and reinsurance. Columbia operates under a certificate of authority to transact the business of insurance (with the exceptions of life and title insurance) issued by the Department of Insurance of the State of Nebraska, and is currently licensed to conduct one or more insurance businesses in sixteen (16) other states. At present, Columbia's business consists primarily

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* On November 30, 1975 two (2) former wholly-owned subsidiaries of Associated, Fashion Outlet of Michigan, Inc. and Anbec, Inc., were merged into Associated. Fashion Outlet of Michigan, Inc., in its former capacity as a Michigan corporation, operated a single women's and children's apparel store on leased premises in Saginaw, Michigan. Associated now operates that store under the name "Fashion Outlet". Anbec, Inc., in its former capacity as an Illinois corporation, owned certain improved real property in Chicago, Illinois, and leased that property to Associated for the latter's operation of one of its retail stores. Associated continues to operate that store.

** Formerly "Reinsurance Corp. of Nebraska".

of the acceptance of portions of reinsurance contracts generated through and offered to Columbia by the reinsurance division of National Indemnity Company (hereinafter referred to as "National Indemnity").

National Indemnity is a wholly-owned subsidiary of Berkshire. Although as of January 31, 1976, Warren E. Buffett, a member of his immediate family, the Company and its subsidiaries owned substantial amounts of the common stock of Berkshire, and although Mr. Buffett is the Chairman of the Board of Directors of the Company, of Associated, of Columbia, and of Berkshire (see ITEM 4. PARENTS AND SUBSIDIARIES and ITEM 12. DIRECTORS OF REGISTRANT), National Indemnity is not obligated to offer all or any portion of any reinsurance contract to Columbia. Accordingly, Columbia cannot be certain that it will continue to be offered business through the reinsurance division of National Indemnity, presently its principal source of business. Columbia currently is dependent upon the continuance of its business arrangements with National Indemnity since Columbia has no independent staff for generating or evaluating business, settling losses or handling other administrative details.

(2) Southern Casualty Insurance Company

On April 30, 1974 Columbia purchased 99.6% of the issued and outstanding voting securites of Southern Casualty Insurance Company (hereinafter referred to as "Southern"). Southern is licensed to write workmen's compensation coverage in the State of Louisiana.

C. Lines of Business and Classes of Similar Products or Services

The Company believes that for purposes of this Item it conducts only one significant line of business; i.e., through Associated, the retailing of women's and children's apparel.

The Company and/or its consolidated subsidiaries (including Columbia), have investments in Berkshire and Blue Chip Stamps (hereinafter referred to as "Blue Chip") which are accounted for by the equity method. Although these investments are not treated as lines of business for purpose of this Item, equity in earnings of these affiliates contribute significantly to consolidated net earnings as set forth in Item 2 following.

The Company's insurance and reinsurance operations, conducted by Columbia and Southern, are not treated as a separate line of business for purposes of this Item because their written premium volume plus their investment income is less than 15% of the sum of consolidated net sales, written insurance premium volume and consolidated investment income. Equity in net earnings of Berkshire and Blue Chip exceeded Columbia's net earnings in each of the past two years; such equity income is reported on a consolidated basis in Item 2 as described above. See also the consolidated financial statements of Columbia Insurance Company and Consolidated Subsidiary included in Item 10(a).

ITEM 2. SUMMARY OF OPERATIONS

THIS SUMMARY SHOULD BE READ IN CONJUNCTION WITH THE FINANCIAL STATEMENTS AND NOTES THERETO INCLUDED IN ITEM 10(a)

	Fiscal Year Ended				
	January 29, 1972	February 3, 1973*	February 2, 1974	February 1, 1975	January 31, 1976
	(In thousands of dollars except per share amounts)				
Net Sales	$38,598	$38,918	$38,399	$34,925	$35,145
Gross Profit and Other Income Items	$13,462	$13,919	$13,904	$13,333	$13,961
Operating Expenses, Except Interest	(11,439)	(11,778)	(12,167)	(11,946)	(12,255)
Interest and Financing Costs	(673)	(687)	(720)	(677)	(714)
Income Taxes Applicable to Operating Earnings	(647)	(703)	(441)	(307)	(489)
Operating Earnings	703	751	576	403	503
Additions to (Deductions from) Operating Earnings, Net of Taxes: Equity in Net Earnings of Affiliated Companies Accounted for by the Equity Method	724	1,972	1,985	1,582	1,559
Realized Gains (Losses) from Securities Transactions	200	195	26	(210)	5
Earnings Before Extraordinary Items	1,627	2,918	2,587	1,775	2,067
Extraordinary Items, Net of Taxes	(111)	-	395	68	-
Net Earnings	$ 1,516	$ 2,918	$ 2,982	$ 1,843	$ 2,067
Per Share (1,000,000 Shares Outstanding):					
Earnings before Extraordinary Items	$ 1.63	2.92	2.59	1.77	2.07
Net Earnings	1.52	2.92	2.98	1.84	2.07

* The fiscal year ended February 3, 1973 consisted of 53 weeks

This summary includes the results of the Company and its subsidiaries on a consolidated basis.

(a) The extraordinary loss for fiscal 1972 resulted from additional income taxes related to sale of a subsidiary in fiscal 1970. The extraordinary gains in fiscal years 1974 and 1975 resulted from receipt of condemnation proceeds for certain Philadelphia properties in excess of depreciated cost of the properties.

MANAGEMENT'S DISCUSSION OF SUMMARY OF OPERATIONS

Operating earnings as reflected in the Summary of Operations have varied only nominally in the past five years in relation both to the scope of operations and to the total stockholders' equity. Improvement in retailing operations was apparent in the most recent fiscal year after some deterioration in the prior year.

The more significant factor influencing earnings before extraordinary items has been the Company's equity in net earnings of Berkshire Hathaway Inc. ("Berkshire") and Blue Chip Stamps ("Blue Chip"). The Company's recorded share of net earnings of these affiliates has been as follows for the past three years, in thousands of dollars:

	Fiscal Year Ended		
	February 2, 1974	February 1, 1975	January 31, 1976
Berkshire	1,220	723	637
Blue Chip	765	859	922
Total	1,985	1,582	1,559

The Company's share ownership of Blue Chip has remained constant for the past three years so that the above reflects increases in Blue Chip's net earnings. The decline in equity in Berkshire's earnings is reflective of decreased earnings of Berkshire, although increased share ownership by the Company in the most recent year partially offset a 33% decline in that company's total reported earnings, to the extent that the Company's equity in Berkshire's net earnings declined by a lesser 12%.

ITEM 3. PROPERTIES

The operating offices of the Company are located in the law firm of Frank, Bernstein, Conaway & Goldman, 1300 Mercantile Bank and Trust Building, 2 Hopkins Plaza, Baltimore, Maryland 21201, in which firm Robert M. Goldman, the President of the Company, and Max E. Blumenthal, the Secretary of the Company, are partners. The Company pays no rent for the said offices and, except for certain legal and bookkeeping activities, only limited operational activities of the Company take place therein.

The stores operated by Associated (see ITEM 1. BUSINESS) range in size of floor area from approximately two thousand (2,000) square feet to approximately sixty thousand (60,000) square feet. The total floor area of all of the stores is approximately nine hundred thousand (900,000) square feet.

Associated owns the land and improvements of eight (8) of its store locations, all of which are in Chicago, Milwaukee, Philadelphia, Chester, Pennsylvania and Gary, Indiana. Associated leases its remaining store locations, for terms expiring on various dates through 1988. The aggregate annual minimum rental paid by Associated during the fiscal year ended January 31, 1976 for the store locations which it leases was approximately $1,495,000. Certain of the leases, however, provide for the payment of additional rent based upon the volume of sales at the particular location, and for the payment by Associated of applicable real property taxes and/or other expenses. (See Note 12 of the Notes to Financial Statements.)

Associated's executive, buying and administrative offices are located in a New York City warehouse (see ITEM

1. BUSINESS) leased by Associated for a term expiring in 1978. The warehouse has a floor area of approximately eighty thousand (80,000) square feet.

Columbia has no independent operating offices and owns no facilities; all of Columbia's activities are supervised by Warren E. Buffett, its President and the Chairman of its Board of Directors, from his offices in Omaha, Nebraska.

ITEM 4. PARENTS AND SUBSIDIARIES

A. Parents

As of April 26, 1976, (See ITEM 6. INCREASES AND DECREASES IN OUTSTANDING SECURITIES), Warren E. Buffett owned 51.49%* of the Company's common stock; First Manhattan Co. (of which David S. Gottesman was and is a general partner) held of record 13.17% of that stock; and Susan T. Buffett, the spouse of Warren T. Buffett, owned approximately 3.95% of that stock. (see ITEM 11. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT and ITEM 12. DIRECTORS OF REGISTRANT.) First Manhattan Co. disclaims any status which would cause it to be deemed a parent Company.

B. Subsidiaries

The Company owns one hundred percent (100%) of the issued and outstanding voting securities of its subsidiary, Associated Retail Stores, Inc., an Illinois corporation. Associated owns one hundred percent (100%) of the issued and

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* This percentage was computed without taking into account Mr. Buffett's interest as trustee under a trust instrument in certain shares of the Company's common stock. See ITEM 11. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT.

outstanding voting securities of its subsidiary, Columbia Insurance Company, a Nebraska corporation. Columbia owns 99.6% of Southern Casualty Insurance Company. The above-named subsidiaries are included in the consolidated financial statements of the Company.

As of January 31, 1976, the Company, through its subsidiary, Associated, and Associated's subsidiary, Columbia, beneficially owned approximately sixteen percent (16%) of the common stock of Blue Chip Stamps, a California corporation, and Warren E. Buffett and his wife beneficially owned approximately thirteen percent (13%) of that stock. On that date, Berkshire and its subsidiaries beneficially owned twenty-six percent (26%) of the common stock of Blue Chip, and David S. Gottesman, a general partner of First Manhattan Co., and members of his immediate family, and members of the immediate family of Charles F. Heider, owned beneficially less than one percent (1%) of that stock. The Company takes up equity in earnings relating to its shareholdings in Blue Chip. For purposes of this Item 4, and pursuant to Instruction No. 6 thereto, Blue Chip is deemed to be a subsidiary.

As of January 31, 1976, the Company and Columbia in the aggregate owned beneficially approximately fifteen percent (15%) of the common stock of Berkshire, a Delaware corporation. In addition, on that date Warren E. Buffett and Susan T. Buffett, his spouse, respectively owned beneficially approximately 33.3% and approximately 2.5% of that stock. The Company takes up equity in earnings relating to its shareholdings in Berkshire. For purposes of this Item 4, and pursuant to Instruction No. 6 thereto, Berkshire is deemed to be a subsidiary.

ITEM 5. PENDING LEGAL PROCEEDINGS

Neither the Company, Associated nor Associated's subsidiary are parties to any material pending legal proceedings other than ordinary routine litigation incidental to their business, and none of their property is the subject thereof.

ITEM 6. INCREASES AND DECREASES IN OUTSTANDING SECURITIES

None as of January 31, 1976.

As of April 26, 1976:

Title of Class	Amount Outstanding As of February 1, 1975	Dates of Transactions	Amount of Increase/ (Decrease)	Amount Outstanding As of April 26, 1976
Diversified Retailing Co., Inc., common stock, par value $0.003 per share	1,000,000	March 17, 1976 to April 26, 1976	(211,877)	788,123

Description of Transactions

After the close of the Company's fiscal year ended January 31, 1976, and up to April 26, 1976, the Company repurchased 211,877 shares of its outstanding $0.0003 par value common stock at Fifteen Dollars ($15.00) per share. The aggregate purchase price paid for those shares was $3,178,155.00, and the Company obtained the funds with which to make the purchases by borrowing from a commercial bank. See NOTE 16 of the Notes to Financial Statements.

ITEM 7. APPROXIMATE NUMBER OF EQUITY SECURITY HOLDERS

Title of Class	Number of Record Holders (a)
Diversified Retailing Co., Inc., common stock, par value $0.0003 per share	67

ITEM 8. EXECUTIVE OFFICERS OF THE REGISTRANT

Name	Age	Offices(s) Held
Warren E. Buffett	45	Chairman of the Board of Directors
Robert M. Goldman (b)	59	President; Director
David S. Gottesman	49	Vice President; Director
Charles T. Munger	52	Vice President; Director
Charles F. Heider	49	Director
Max E. Blumenthal (b)	35	Secretary
Larry C. Cummings (b)	32	Treasurer; Assistant Secretary

ITEM 9. INDEMNIFICATION OF DIRECTORS AND OFFICERS

The Company has no charter provision, by-law, contract or arrangement under or pursuant to which any of its Directors or Officers are insured or indemnified in any manner against any liability which may be incurred in their capacity as such. However, under Section 2-418 of the Corporations and Associations Article of the Annotated Code of Maryland, the Company may indemnify any Director, officer, employee or agent of the Company against any expenses or

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(a) The information is given as of April 26, 1976.

(b) Both Mr. Goldman and Mr. Blumenthal are partners in the law firm of Frank, Bernstein, Conaway & Goldman, 1300 Mercantile Bank and Trust Building, 2 Hopkins Plaza, Baltimore, Maryland 21201, which firm represents the Company. Mr. Cummings is an employee of that firm.

liability incurred as a result of his good faith performance of duty in such capacity, subject to certain restrictions upon such indemnification, which are provided in the said statute.

ITEM 10. FINANCIAL STATEMENTS AND EXHIBITS FILED

A. Financial Statements

A list of the consolidated financial statements and schedules of the Company and/or of the consolidated insurance subsidiaries which are filed herewith immediately precedes those documents herein.

B. Exhibits Filed

Exhibit A: 1975 Annual Report of Berkshire Hathaway, Inc.

Exhibit B: Accountant's Report and Financial Statements from 1976 Annual Report of Blue Chip Stamps

Exhibit C: 1975 Annual Report of Wesco Financial Corporation

PART II

ITEM 11. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT

A. Principal Security Holders

Name and Address	Title of Class	Type of Ownership	Amount Owned (a)	Percent of Class (a)
Warren E. Buffett 5505 Farnam Street Omaha, Nebraska 68131	common	record and beneficial	440,636(b)	55.9%
First Manhattan Co. 30 Wall Street New York, New York 10005	common	record only	103,787(c)	13.17%

(a) The information is given as of April 26, 1976.

(b) This amount includes the following shares of common stock, as to which Mr. Buffett disclaims the beneficial ownership:

(i) 31,113 shares held by Mr. Buffett's wife, Susan T. Buffett;

(ii) 3,732 shares held in trust under the Last Will and Testament of Howard H. Buffett, deceased, as to which Mr. Buffett is the trustee;

(c) As a general partner of First Manhattan Co., David S. Gottesman, a Director and a Vice President of the Company, beneficially owned 35,000 of the said 103,787 shares. An additional 12,895 of the said 103,787 shares are held in trust for the benefit of certain members of Mr. Gottesman's immediate family and an additional 10,031 of the said 103,787 shares are owned beneficially by a member of Mr. Gottesman's immediate family. The remaining 45,861 of the 103,787 shares are owned beneficially by the other partners of the firm or their personal representatives. Mr. Gottesman disclaims the beneficial ownership of the shares held in the said trust and of the shares owned by the member of his immediate family.

B. Security Holdings of Management

Title of Class	Amount Beneficially Owned (d)	Percent of Class
Diversified Retailing Co., Inc., common stock, par value 0.0003 per share (e)	473,191 (f)	60.04%

ITEM 12. DIRECTORS OF THE REGISTRANT

Each of the following persons served as a Director of the Company during the entire fiscal year ended January 31, 1976.

(d) Subject to the exceptions indicated in note (f) to this Item, this column indicates the number of shares of the common stock of the Company beneficially owned directly or indirectly by all Directors and Officers of the Company, as a group, as of April 26, 1976.

(e) The Company has no other class of equity securities. No Director or Officer possesses the beneficial ownership of any share or shares of equity securities of the Company's subsidiary, Associated, or of Associated's subsidiary, Columbia.

(f) This amount does not include any of the following shares of common stock:

(i) the shares referred to in note (b) to this Item, which note is incorporated herein by reference;

(ii) the 12,895 shares held in trust for the benefit of certain members of David S. Gottesman's immediate family and 10,031 shares owned beneficially by a member of Mr. Gottesman's immediate family referred to in note (c) to this Item, which note is incorporated herein by reference.

A. Warren E. Buffett

Warren E. Buffett is the Chairman of the Board of Directors of the Company, having held that office since the Company's organization in 1966. Since 1970, Mr. Buffett has been the Chairman of the Board of Directors of Associated and of Berkshire, and the Chairman of the Board of Directors and President of Columbia.

B. David S. Gottesman

David S. Gottesman, a Director and a Vice President of the Company, is and has been for the past five years a general partner in the broker-dealer securities firm of First Manhattan Co., a member of the New York Stock Exchange.

C. Charles T. Munger

Charles T. Munger, a Director and a Vice President of the Company, has been for the past five years, and until January, 1976, a general partner in the broker-dealer securities firm of Wheeler, Munger & Co., a member of the Pacific Coast Stock Exchange. Since January, 1976, Mr. Munger's principal occupation has consisted of the management of personal investments.

D. Charles F. Heider

Charles F. Heider, a Director of the Company, is and has been since 1970 the President of Chiles, Heider & Co., Inc., a broker-dealer securities firm and a member of the New York Stock Exchange.

E. Robert M. Goldman

Robert M. Goldman, a Director and the President of the Company, is and has been since July 1, 1966, a partner of the Maryland law firm of Frank, Bernstein, Conaway & Goldman.

ITEM 13. REMUNERATION OF DIRECTORS AND OFFICERS

Name of Individual or Number of Persons in Group	Capacities in which Remuneration was Received	Aggregate direct Remuneration (a)
Larry C. Cummings	Treasurer	$500.00
All seven Directors and Officers as a group		$500.00 (b)

ITEM 14. OPTIONS GRANTED TO MANAGEMENT TO PURCHASE SECURITIES

None

ITEM 15. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS

A. Other than the following, there have been no transactions since the beginning of the fiscal year ended

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(a) Subject to the exceptions indicated in note (b) to this Item, this column indicates the aggregate amount of direct remuneration paid by the Company, Associated and Associated's subsidiaries to the person or persons specified, in all capacities, during the Company's fiscal year ended January 31, 1976.

(b) This amount does not include legal fees and cash advanced in the amounts of $7,328.50 and $589.74 respectively, which the Company accrued during its fiscal year ended January 31, 1976, to the law firm of Frank, Bernstein, Conaway & Goldman, in which Messrs. Goldman and Blumenthal are and were at the time of such payment partners. Nor does the said amount include any additional such legal fees incurred by the Company between January 1, 1976, and January 31, 1976, for which amounts the said firm had not billed the Company as of January 31, 1976. (See ITEM 15. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS.)

January 31, 1976, nor are there any presently proposed transactions, to which the Company, Associated or Associated's subsidiary was or is to be a party, in which any Director or Officer of the Company, or any security holder named under section A of Item 11 hereof, or any relative or spouse of any of the foregoing persons who has the same home as such person or who is a Director or Officer of the Company or of Associated or of Associated's subsidiary, had or is to have a direct or indirect material interest:*

(1) During the Company's fiscal year ended January 31, 1976, Columbia accepted reinsurance contracts from National Indemnity, of which Warren E. Buffett is the Chairman of the Board of Directors, representing premiums written in the approximate amount of $1,973,000. See Note 9 to Columbia's financial statements presented elsewhere. National Indemnity performs all of Columbia's bookkeeping and other administrative functions. For these services Columbia pays to National Indemnity as part of its ceding commissions an amount ordinarily equal to one-half of the customary originating brokerage commissions. "Pro rata" business normally carries an originating commission of 1%, and "excess" business, an originating commission of 10%. The amount of ceding commissions representing fees for bookkeeping and administrative services paid by Columbia to National Indemnity during 1975 was approximately $12,850.

(2) During the Company's fiscal year ended January 31, 1976, the Company paid and/or incurred certain legal fees in connection with the representation of the

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* Mr. Benjamin F. Rosner, the President of Associated (but neither an Officer nor a Director of the Company), owns and leases to Associated the land and improvements upon which Associated operates one of its retail stores.

Company by the law firm of Frank, Bernstein, Conaway & Goldman. (See note (b) to ITEM 13. REMUNERATION OF DIRECTORS AND OFFICERS.)

(3) After the close of the Company's fiscal year ended January 31, 1976, M. Peter Moser, a partner in the law firm of Frank, Bernstein, Conaway & Goldman (in which Messrs. Goldman and Blumenthal are partners), or members of Mr. Moser's immediate family, sold 2,211 shares of the Company's $0.0003 par value common stock, which Mr. Moser or members of his immediate family owned beneficially, to the Company for the aggregate sum of $33,165.

B. During the Company's fiscal year ended January 31, 1976, no Director or Officer of the Company or associate of such persons was indebted to the Company, Associated or Associated's subsidiary.

C. Other than any payments which may have been made pursuant to the terms of any pension, retirement, savings or similar plan which may have been provided by the Company, Associated or Associated's subsidiary, during the Company's fiscal year ended January 31, 1976, there was no transaction, and there is no presently proposed transaction, to which any of the said plans was or is to be a party, in which any Director or Officer of the Company, any security holder named under section A of Item 11 hereof, or any relative or spouse thereof or relative of any such spouse who has the same home as any such Director, Officer or security holder or who is a Director or Officer of Associated or Associated's subsidiary, had or is to have a direct or indirect material interest.

* * * * * * * *

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DIVERSIFIED REATILING COMPANY, INC.

By Robert M. Goldman
Robert M. Goldman, President

Dated: April 30, 1976

Item 10. Financial Statements and Exhibits Filed

(a) Financial Statements

Index to Financial Statements

Item 10. Financial Statements and Exhibits Filed (Continued)

(a) Financial Statements, Cont.

(b) Exhibits

A - Annual Report of Berkshire Hathaway Inc. - 1974 and 1975

B - Annual Report of Blue Chip Stamps - 1976

C - Annual Report of Wesco Financial Corporation - 1974 and 1975

All other Schedules are omitted because the information required therein is not applicable or is given in the financial statements or the notes thereto.

PEAT, MARWICK, MITCHELL & CO.

CERTIFIED PUBLIC ACCOUNTANTS

ACCOUNTANTS' REPORT

The Board of Directors
Diversified Retailing Company, Inc.:

We have examined the financial statements and related schedules of Diversified Retailing Company, Inc. and subsidiaries and Diversified Retailing Company, Inc. (parent Company only) as listed in the accompanying index, so far as they relate to the year ended January 31, 1976. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an affiliated company. The Company and its subsidiaries' investment in Blue Chip Stamps at January 31, 1976 was $13,264,615 and its equity in earnings of Blue Chip Stamps was $921,531 for the year then ended. The financial statements of Blue Chip Stamps were examined by other auditors whose qualified report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Blue Chip Stamps, is based solely upon the report of the other auditors.

The report of the other auditors on the financial statements of Blue Chip Stamps for the year ended February 28, 1976 was qualified with respect to the outcome of certain legal proceedings. These legal proceedings are explained in note 7 of notes to the financial statements.

In our opinion, based upon our examination and the report of the other auditors and subject to the effect, if any, upon the investment in Blue Chip Stamps resulting from the ultimate outcome of the legal proceedings referred to in the preceding paragraph, the aforementioned financial statements present fairly the consolidated financial position of Diversified Retailing Company, Inc. and subsidiaries at January 31, 1976 and the results of their operations and the changes in their financial position for the year then ended, and the financial position of Diversified Retailing Company, Inc. (parent Company only) at January 31, 1976 and the results of its operations and changes in its financial position for the year then ended, all in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year, except for the change, with which we concur, in the valuation of marketable equity securities, as described in note 1 of notes to financial statements; and the supporting schedules, for the year ended January 31, 1976, in our opinion, subject to the effect of the matter discussed in the preceding paragraph, present fairly the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.
Peat, Marwick, Mitchell & Co.

Omaha, Nebraska
April 15, 1976

ERNST & ERNST
ONE NORTH CHARLES
BALTIMORE, MARYLAND
21201

Board of Directors
Diversified Retailing Company, Inc.
Baltimore, Maryland

We have examined the balance sheet of Diversified Retailing Company, Inc. (parent company) as of February 1, 1975, and the related statements of earnings, retained earnings and changes in financial position for the year then ended and the consolidated balance sheet of Diversified Retailing Company, Inc. and subsidiaries as of February 1, 1975, and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended and the related schedules listed in the accompanying index for the year ended February 1, 1975. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements include the equity in earnings of certain affiliated companies. The financial statements of these companies used as the basis of recording such equity in earnings and those of the consolidated insurance subsidiary were examined by other auditors whose reports were furnished to us. The consolidated financial statements of Columbia Insurance Company, the insurance subsidiary, reflect total assets and net earnings constituting 36% and 15% in 1975, respectively, of the related consolidated totals. Our opinion expressed herein, insofar as it relates to the amounts included for the consolidated insurance subsidiary and to the amount of income included for those affiliated companies for the year ended February 1, 1975, is based solely on the reports of other auditors.

The report of the other auditors on the financial statements of Blue Chip Stamps (Blue Chip), an affiliated company, is qualified with respect to the resolution of pending legal proceedings referred to in the footnotes to the financial statements of Blue Chip, which statements are included as Exhibit C to this annual report on Form 10-K. The investment in Blue Chip is carried at cost plus equity in undistributed earnings, which at February 1, 1975 aggregated $13,249,000.

In our opinion, based upon our examination and the aforementioned reports of other auditors and subject to the effect, if any, on the financial statements resulting from the ultimate outcome of the legal proceedings referred to in the preceding paragraph, the financial statements referred to above present fairly the financial position of Diversified Retailing Company, Inc. (parent company) and the consolidated financial position of Diversified Retailing Company, Inc. and subsidiaries at February 1, 1975, and the respective results of their operations and changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a consistent basis, after restatement for the changes, with which we concur, in the method of accounting for the investment in the insurance subsidiary as described in Note 1 to the consolidated financial statements, and in the terms used to express changes in financial position from working capital to cash as shown in both the parent company and consolidated financial statements. Further, it is our opinion that Schedules III (subject to the effect of the aforementioned legal proceedings), and XVI referred to above for the year ended February 1, 1975 present fairly the information set forth therein in compliance with the applicable accounting regulations of the Securities and Exchange Commission.

Ernst & Ernst
ERNST & ERNST

Baltimore, Maryland
April 28, 1975

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

February 1, 1975 and January 31, 1976

Assets	1975	1976
Cash	$ 4,462,878	4,018,061
U. S. Treasury bills, at cost which approximates market	1,806,004	2,421,690
Accounts receivable (note 2)	901,630	470,941
Merchandise inventories	4,220,012	4,739,021
Investments, other than affiliates (notes 3 and 4):		
Bonds, at amortized cost	1,788,450	2,199,877
Common stocks, at cost, 1975; market, 1976	1,221,755	533,833
Total investments, other than affiliates	3,010,205	2,733,710
Investments in affiliates (notes 6, 7 and 9) (Schedule III):		
Berkshire Hathaway Inc.	10,184,776	12,641,809
Blue Chip Stamps	13,249,060	13,264,615
Total investments in affiliates	23,433,836	25,906,424
Property and equipment, at cost less allowance for depreciation and amortization of $507,070 in 1975 and $539,328 in 1976 (note 8)	925,198	929,696
Other assets	709,156	744,526
	$ 39,468,919	41,964,069

Liabilities and Stockholders' Equity	1975	1976
Losses and loss adjustment expenses	$ 3,730,000	4,019,020
Unearned insurance premiums	1,224,835	1,116,749
Accounts payable and accruals	2,057,703	2,433,881
Salaries, wages and bonuses	145,524	127,796
Taxes other than income taxes	288,080	313,946
Income taxes (note 10):		
Current	419,304	445,203
Deferred	522,129	698,245
Notes payable to banks (note 9)	-	350,000
8% debentures due 1985 (note 9)	6,600,000	6,600,000
9% notes payable (note 9)	1,239,154	1,372,709
Other liabilities	496,404	512,890
Total liabilities	16,723,133	17,990,439
Stockholders' equity (notes 9 and 11):		
Common stock of $.0003 par value. Authorized 3,333,333-1/3 shares; issued 1,000,000 shares	300	300
Additional paid-in capital	5,999,700	5,999,700
Net unrealized loss on marketable equity securities	-	(839,303)
Retained earnings	16,745,786	18,812,933
Total stockholders' equity	22,745,786	23,973,630
Commitments and contingent liabilities (notes 12, 13 and 16)		
	$ 39,468,919	41,964,069

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings and Retained Earnings

Years ended February 1, 1975 and January 31, 1976

	1975	1976
Net sales (including leased department sales of $948,151, 1975; $1,063,197, 1976)	$ 34,924,966	36,144,691
Cost of goods sold	21,828,566	22,267,010
Gross profit	13,096,400	13,877,681
Insurance underwriting (loss)	(374,221)	(581,874)
Interest and dividend income	414,000	445,177
Other income	196,519	220,770
	13,332,698	13,961,754
Selling, general and administrative expenses	11,946,426	12,254,693
Interest and financing costs	676,758	714,304
	12,623,184	12,968,997
Earnings before income taxes, equity in earnings of affiliates, realized securities gains and losses and extraordinary item	709,514	992,757
Income taxes (note 10)	306,796	488,969
Earnings before equity in earnings of affiliates, realized securities gains and losses and extraordinary item	402,718	503,788
Equity in earnings of affiliates (notes 6 and 7):		
Berkshire Hathaway Inc.	722,671	637,118
Blue Chip Stamps	859,011	921,531
	1,581,682	1,558,649
Earnings before realized securities gains and losses and extraordinary item	1,984,400	2,062,437
Realized gains (losses) on sales of securities, net of taxes (credit) in 1975 of ($89,894) and in 1976 of $2,017	(209,754)	4,710
Earnings before extraordinary item	1,774,646	2,067,147
Extraordinary item (note 14)	68,391	-
Net earnings	1,843,037	2,067,147
Retained earnings at beginning of year	14,902,749	16,745,786
Retained earnings at end of year	$ 16,745,786	18,812,933
Earnings per share:		
Earnings before equity in earnings of affiliates, realized securities gains (losses) and extraordinary item	$ .40	.50
Equity in earnings of affiliates	1.58	1.56
Realized securities gains (losses)	(.21)	.01
Extraordinary item	.07	-
Net earnings	$ 1.84	2.07

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position

Years ended February 1, 1975 and January 31, 1976

	1975	1976
Funds provided:		
From operations:		
Net earnings before extraordinary item	$ 1,774,646	2,067,147
Charges (credits) to earnings not requiring (providing) funds:		
Equity in current earnings of affiliates, net of deferred taxes	(1,581,682)	(1,558,649)
Dividends received from affiliates, net current taxes	187,506	187,508
Increase in unpaid losses and loss adjustment expenses	1,124,859	289,020
Increase (decrease) in unearned insurance premiums	158,409	(108,086)
Increase in accounts payable and accrued expenses	1,315,345	384,316
Depreciation and amortization of fixed assets	125,659	120,992
Provision for (reversal of) anticipated losses on common stocks, net of $90,000 deferred tax benefit	210,000	(210,000)
Loss (gain) on sale of investments	(352)	293,273
Decrease (increase) in inventories	93,430	(519,009)
Decrease (increase) in accounts receivable	(20,489)	430,689
Increase (decrease) in income taxes currently payable	(1,148)	25,899
Increase (decrease) in other liabilities	60,446	16,486
Amortization of excess of carrying amounts of net assets of consolidated subsidiaries over acquisition costs	(106,875)	(106,980)
All other	2,963	(3,342)
Funds provided from operations, excluding extraordinary item	3,342,717	1,309,264
Extraordinary item	68,391	-
Funds provided from operations	3,411,108	1,309,264
Decrease in cash	-	444,817
Proceeds from sale of investments:		
Bonds	-	203,887
Common stocks	30,286	659,364
Increase in notes payable to bank	-	350,000
Proceeds from issuance of 9% notes	-	163,786
	$ 3,441,394	3,131,118
Funds used:		
Investment in Berkshire Hathaway Inc.	-	1,771,442
Purchase of insurance subsidiary	497,800	-
Other investments:		
Bonds	191,055	588,269
Common stocks	15,000	-
Additions to property, plant and equipment, net	129,263	125,490
Debt repayment	3,731	30,231
Increase in treasury bills	1,143,415	615,686
Increase in cash	1,461,130	-
	$ 3,441,394	3,131,118

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Balance Sheets

February 1, 1975 and January 31, 1976

Assets	1975	1976
Cash	$ 7,336	49,718
Note receivable from subsidiary	6,600,000	6,600,000
Investment in subsidiary (note 5) (Schedule III)	22,025,026	18,141,285
Investment in affiliated company (note 6) (Schedule III)	2,250,819	7,886,196
Unamortized cost of long-term financing	302,868	274,666
	$ 31,186,049	32,951,865

Liabilities and Stockholders' Equity		
Accrued interest and other expenses	$ 180,691	177,232
Due to subsidiary	50,959	152,524
Deferred income taxes	74,404	161,845
Note payable to bank (note 9)	-	350,000
8% debentures (note 9)	6,600,000	6,600,000
9% notes payable (note 9)	1,239,154	1,372,709
Unamortized excess of carrying amount of net assets of subsidiary over acquisition cost	295,055	163,925
Stockholders' equity (notes 9 and 11):		
Common stock of $.0003 par value. Authorized 3,333,333-1/3 shares; issued 1,000,000 shares	300	300
Additional paid-in capital	5,999,700	5,999,700
Net unrealized loss on marketable equity securities	-	(839,303)
Retained earnings	16,745,786	18,812,933
Total stockholders' equity	22,745,786	23,973,630
	$ 31,186,049	32,951,865

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Statements of Earnings and Retained Earnings

Years ended February 1, 1975 and January 31, 1976

	1975	1976
Interest income	$ 528,000	528,000
Amortization of excess of net assets of subsidiary over acquisition cost	131,130	131,130
	659,130	659,130
Expenses:		
General and administrative	55,618	29,127
Interest and financing costs	667,810	676,565
	723,428	705,692
Loss before income taxes and equity in net earnings of subsidiary and affiliated company	(64,298)	(46,562)
Income tax credit	97,156	88,846
Earnings before equity in net earnings of subsidiary and affiliated company	32,858	42,284
Equity in net earnings of subsidiary (note 5)	1,630,378	1,744,319
Equity in net earnings of affiliated company (notes 6 and 7)	179,801	280,544
Net earnings	1,843,037	2,067,147
Retained earnings at beginning of year	14,902,749	16,745,786
Retained earnings at end of year	$ 16,745,786	18,812,933
Earnings per share:		
Earnings before equity in net earnings of subsidiary and affiliated company	$ .03	.04
Equity in net earnings of subsidiary	1.63	1.75
Equity in net earnings of affiliated company	.18	.28
Net earnings	$ 1.84	2.07

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Statements of Changes in Financial Position

Years ended February 1, 1975 and January 31, 1976

	1975	1976
Funds provided:		
From operations:		
Net earnings	$ 1,843,037	2,067,147
Charges (credits) to earnings not requiring (providing) funds:		
Increase (decrease) in accrued expenses	988	(3,459)
Amortization of excess of carrying amounts of net assets of subsidiary over acquisition cost	(131,130)	(131,130)
Amortization of long-term financing costs	28,203	28,202
Equity in undistributed net earnings of subsidiary	(1,630,378)	(1,744,319)
Equity in undistributed net earnings of Berkshire Hathaway Inc.	(179,801)	(280,544)
Funds provided from (used in) operations	(69,081)	(64,103)
Proceeds from borrowings	-	513,786
Net advances from subsidiary	4,844	101,565
Dividend from subsidiary	-	4,788,757
Decrease in cash	67,968	-
	$ 3,731	5,340,005
Funds used:		
Investment in affiliated company	-	5,267,392
Increase in cash	-	42,382
Repayment of debt	3,731	30,231
	$ 3,731	5,340,005

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

February 1, 1975 and January 31, 1976

(1) Summary of Significant Accounting Policies

(a) Principles of Consolidation

Diversified Retailing Company, Inc. (the Company) is a holding company and has no operations. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Associated Retail Stores, Inc. ("Associated") and Columbia Insurance Company ("Columbia"), wholly-owned by Associated. All significant intercompany accounts and transactions have been eliminated in consolidation. Separate financial statements of the parent Company have been included herein. This presentation differs from that used in financial statements issued prior to fiscal 1975 by the Company, in which Associated's investment in Columbia was carried on the equity basis. Because of the nature of the insurance assets and liabilities now consolidated, the accompanying consolidated balance sheets no longer distinguish between current and noncurrent assets and liabilities.

(b) Investment in Subsidiary

The investment in Associated is accounted for under the equity method in the parent Company only financial statements. At the date of acquisition of Associated by the Company, the carrying amount of the net assets was in excess of the investment. Such excess amounted to $1,311,309 and is being amortized to income over a ten-year period. The unamortized balance of $295,055 at February 1, 1975 and $163,925 at January 31, 1976 is included in other liabilities in the consolidated balance sheets.

(c) Investment in Affiliated Companies

The Company and its subsidiaries hold common stock investments in Berkshire Hathaway Inc. and Blue Chip Stamps and account for such investments by use of the equity method. Deferred income taxes are provided for with respect to undistributed earnings under the assumption that such earnings will ultimately be distributed as taxable dividends.

For the year ended January 31, 1976, the Company and its subsidiaries have reflected a direct charge to stockholders' equity which represents their share of the unrealized loss that existed at February 28, 1976 in the marketable equity securities owned by an affiliate. The change in accounting method was made pursuant to the dictates of Statement of Financial Accounting Standards No. 12. No tax effect has been recognized with respect to this unrealized loss.

Blue Chip Stamps determines income on the basis of a fiscal year ending on or about February 28; the Company has not recognized this difference in its annual accounting for its equity in earnings of Blue Chip Stamps, having recorded its equity in earnings of Blue Chip's year ending with respect to February 28, in its year ending with respect to the preceding January 31.

(d) Investments, Other Than Investments in Affiliated Companies

These investments represent those of insurance subsidiaries.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

Investments in bonds are stated at amortized cost. The aggregate market value of bonds has not been determined but, at both February 1, 1975 and January 31, 1976, would be less than cost. No provision has been made for possible losses on bonds since the subsidiaries generally intend to hold bonds to maturity and do not expect to realize any significant losses upon their disposition.

Investments in common stocks are stated at cost less a valuation allowance for anticipated losses, at February 1, 1975, and at the lower of aggregate cost or market value at January 31, 1976. This change in accounting method was made pursuant to the dictates of Statement of Financial Accounting Standards No. 12. The reduction from cost to market value is reflected as a direct charge to stockholders' equity. No tax effect has been recognized with respect to this unrealized loss.

(e) Merchandise Inventories

Inventories are priced at the lower of cost or market by use of the retail inventory method except as to warehouse inventories where cost is determined by the first-in, first-out method.

(f) Property and Equipment

Property and equipment represents that of the retailing subsidiaries. Expenditures for maintenance, repairs, renewals and betterments which represent improvements are capitalized; other such items are charged to current operations. At the time assets are retired or otherwise disposed of, the cost and related allowance for depreciation are eliminated from the asset and allowance accounts and any profit or loss on disposition is reflected in current operations. When assets become fully depreciated, the cost and related allowance for depreciation are written off.

Depreciation for both financial accounting and income tax purposes is based on the 150% declining balance method as to buildings and on the straight-line method for substantially all other property and equipment.

(g) Financing Costs

Certain costs incurred in connection with the issuance by the Company of its 8% debentures have been capitalized and are being ratably amortized over the stipulated life of the debentures. Unamortized financing costs included in other assets in the consolidated balance sheets at February 1, 1975 and January 31, 1976 were $302,868 and $274,666, respectively.

(h) Losses and Loss Adjustment Expenses of Consolidated Insurance Subsidiaries

The provision for losses and loss adjustment expenses is based upon past experience and estimates received relating to assumed reinsurance and estimates of unreported losses.

(i) Insurance Premiums

Insurance premiums are recognized as earned ratably over the terms of the policies. Unearned premiums are computed on a monthly pro rata basis. Policy acquisition costs or commissions are deferred when considered recoverable and charged against income ratably over the terms of the policies for purposes of determining consolidated results of the Company and its subsidiaries.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(j) Federal Income Taxes

The Company and its subsidiaries file a consolidated Federal income tax return. Insurance subsidiaries account for certain items of income and expense differently for financial reporting purposes than for income tax reporting purposes. Provisions are made for deferred taxes in recognition of these timing differences.

The investment tax credit (not material) is accounted for as a reduction of Federal income taxes in the year in which the credit arises.

(2) Accounts Receivable

Accounts receivable consisted of the following:

	Feb. 1,1975	Jan.31,1976
Layaway accounts and other receivables of retailing operations	$ 258,528	241,733
Uncollected premiums, net of commissions payable, of insurance operations	581,865	185,910
Reinsurance recoverable on loss payments	26,241	-
Investment income due and accrued	34,996	43,298
	$ 901,630	470,941

(3) Securities Deposited With Others

Insurance subsidiaries had deposited the following securities in trust with regulatory authorities or with ceding reinsurers in accordance with reinsurance treaties:

	Dec.31,1974	Dec.31,1975
Bonds, at amortized cost	$ 1,065,551	973,050
Stocks, including those of affiliates, at cost	2,041,042	3,079,663

(4) Investments in Common Stocks of Unaffiliated Companies

At December 31, 1974, Columbia recognized as a realized loss a $300,000 provision for estimated losses on common stocks of unaffiliated companies. The investment in such stocks is reported at cost less the allowance for anticipated losses at that date and at market value at December 31, 1975. The investment in common stocks of unaffiliated companies and the related market values are as follows:

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(4), Continued

	1974	1975
Cost	$ 1,521,755	563,136
Less allowance for anticipated losses	300,000	-
Less net unrealized loss	-	29,303
Carrying value	$ 1,221,755	533,833
Approximate market value	$ 849,700	533,833

At December 31, 1975 gross unrealized gains were $6,376 and gross unrealized losses were $35,679. A net realized gain of $6,727 (before applicable income taxes) on the sale of securities was included in the determination of net earnings for 1975.

(5) Investment in Subsidiary

The carrying value of the investment in common stock of Associated represents the cost plus equity in undistributed earnings since date of acquisition. This investment is summarized as follows:

	Feb. 1,1975	Jan.31,1976
Underlying net asset values at date of acquisition	$ 7,417,659	7,417,659
Additional capital contribution	11,139,732	11,139,732
Equity in post-acquisition undistributed earnings	3,467,635	423,197
Excess of cost over market value of subsidiary and affiliate's marketable equity securities applicable to the Company's equity interest	-	(839,303)
Carrying value	$ 22,025,026	18,141,285

(6) Investment in Berkshire Hathaway Inc.

The carrying value of the investment in common stock of Berkshire Hathaway Inc. (Berkshire) represents the cost plus the equity in earnings since dates of acquisition, adjusted for amortization on a forty year basis of the excess cost over underlying net asset values at dates of acquisition. This is summarized as follows:

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(6), Continued

	Feb. 1,1975	Jan.31,1976
Shares owned	109,551	147,615
Percentage of total outstanding shares	11%	15%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 6,299,019	9,738,578
Excess cost (excess book value), net of amortization of $4,713 at February 1, 1975 and ($7,612) at January 31, 1976	328,061	(1,327,461)
	6,627,080	8,411,117
Equity in post-acquisition earnings	3,557,696	4,230,692
Carrying value	$ 10,184,776	12,641,809

Deferred income taxes of approximately $255,000 at February 1, 1975 and $304,000 at January 31, 1976 have been provided with respect to the equity in post-acquisition earnings, assuming their ultimate distribution as a taxable dividend.

In November 1975 Associated paid a dividend to the Company in the form of its investment in the common stock of Berkshire. The amount of the dividend was $4,788,757 and represented Associated's carrying value at that date. The Company's investment in Berkshire is summarized as follows:

	Feb. 1,1975	Jan.31,1976
Shares owned	26,392	98,900
Percentage of total outstanding shares	3%	10%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 1,334,026	7,069,566
Excess cost (excess book value), net of amortization of ($18,237) at February 1, 1975 and ($18,211) at January 31, 1976	(129,941)	(1,444,631)
	1,204,085	5,624,935
Equity in post-acquisition earnings	1,046,734	2,261,261
Carrying value	$ 2,250,819	7,886,196

Deferred income taxes of approximately $74,000 at February 1, 1975 and $162,000 at January 31, 1976 have been provided with respect to the equity in post-acquisition earnings.

Financial statements of Berkshire are included elsewhere herein.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(7) Investment in Blue Chip Stamps

The carrying value of the investment in Blue Chip Stamps (Blue Chip) represents the cost, less amortization of the net excess of cost over equity in net assets at dates of acquisition, plus equity in undistributed earnings. Deferred taxes of $290,000 at February 1, 1975 and $382,000 at January 31, 1976 have been provided with respect to the equity in undistributed earnings, assuming their ultimate distribution as a taxable dividend. The investment in Blue Chip is summarized as follows:

	Feb. 1,1975	Jan.31,1976
Shares owned	841,900	841,900
Percentage of total outstanding shares	16%	16%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 6,988,300	6,988,300
Net excess cost, less amortization of $1,068,500 at February 1, 1975 and $1,514,214 at January 31, 1976	2,228,571	1,782,857
	9,216,871	8,771,157
Equity in post-acquisition undistributed earnings	4,032,189	5,303,458
Excess of cost over market value of Blue Chip Stamps' marketable equity securities at February 28, 1976 applicable to the Company's equity interest	-	(810,000)
Carrying value	$ 13,249,060	13,264,615

The excess of cost over equity in net assets is being amortized over seven years from the beginning of 1974. Amortization was $445,714 for 1975 and 1976. Dividends from Blue Chip were $202,056 in each of the fiscal years ended February 1, 1975 and January 31, 1976.

In addition to the shares of Blue Chip owned by the Company and its subsidiaries, Berkshire owned approximately 26% of the outstanding shares at both dates and Warren E. Buffett, Chairman of the Board, and his wife owned 13% of Blue Chip's shares at both dates. Financial statements of Blue Chip and Wesco Financial Corporation, a 64% owned subsidiary of Blue Chip, are included elsewhere herein. The accountants' report on Blue Chip's financial statements was given subject to the effect, if any, of certain legal proceedings and the financial statements include the following note (the "Company" refers to Blue Chip Stamps):

> "Pursuant to an antitrust action filed by the Federal Government a consent final judgment was entered in 1967 providing for, among other things, a plan to offer for sale one-third of the Company's California trading stamp business located within a contiguous geographical area in Southern California. That portion of the judgment has been suspended indefinitely by stipulation and court order signed in March 1976.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

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The Company is a defendant in a purported class action filed March 1, 1971 to recover for stamp savers monies collected by it as reimbursement for California sales taxes on redemption of stamps. Plaintiffs claim that redemption transactions are not taxable and that all such collections should be returned or, alternatively, that such collections exceeded the tax properly payable and such excess should be returned. The Company has paid sales taxes to the state equal to its reimbursement collections. The Company has asserted claims against the state for reimbursement of all or part of any recovery by plaintiffs. Following denial of these claims by the state, the Company cross-complained against the state seeking indemnity. The original class action complaint against the Company was amended to assert fraud and to seek punitive damages. On June 1, 1973 two partial summary judgments were entered by way of interlocutory orders, neither of which has yet become final. The first was in favor of the Company to the effect that the redemption transactions were taxable. The second was in favor of plaintiffs to the effect that the Company's collections exceeded the tax properly payable. In the opinion of counsel for the Company, the second partial summary judgment was erroneous. The class action complaint was also amended effective September 19, 1974 to assert, in substance, that the Company's predecessor had engaged in similar conduct from 1961 until its merger into the Company in 1968, and that the Company must respond in respect of the alleged liability of its predecessor to plaintiffs and the persons they purport to represent for overreimbursement of sales taxes. On October 24, 1975 the California Supreme Court granted the petition of Blue Chip Stamps for an alternative writ of mandate to determine (1) whether the trial court properly certified the action as a class action and set it for trial without any notice to members of the purported class and (2) whether or not an order for partial summary judgment previously entered was erroneous. Proceedings in the trial court are stayed pending final determination of the mandate proceedings in the California Supreme Court. Issues relating to the class action aspects of the case remain unresolved along with a number of issues of fact. Maximum liability in respect of this action as amended may be as high as $17,000,000 less the amount of any money which may be recovered on the claims against the state. Counsel believes the prospects for some such recovery to be good. In the opinion of counsel for the Company, substantial defenses are available, but counsel cannot predict the ultimate outcome of the action.

A purported class action was filed under Federal securities laws on November 10, 1970 against the Company and certain of its present and former stockholders and directors, on behalf of retailer users of Blue Chip Stamps who failed to purchase securities of the Company in a 1968 offering to retailer users. The complaint alleged damages to plaintiffs of $21,400,000, together with exemplary damages of $25,000,000, interest, attorneys' fees and costs, and prayed that plaintiffs have the right to purchase securities of the Company on the terms of the 1968 offering. After hearings

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in the United States District Court and the United States Court of Appeals for the Ninth Circuit, the Supreme Court of the United States in a decision rendered on June 9, 1975 held that the purported class did not have standing to bring such an action. Accordingly, the Federal action is concluded. On June 5, 1974 the Company was served with a complaint in a substantially identical action based on California corporate and common law filed in Los Angeles County Superior Court on June 21, 1971. Although plaintiffs are pursuing the state court action, in the opinion of counsel for the Company, upon the facts now known, the present state of the law and the decision of the Supreme Court in the Federal action, there appear to be substantial defenses on the merits."

(8) Property and Equipment

Property and equipment are comprised of the following:

	Feb. 1,1975	Jan.31,1976
Land	$ 231,715	231,715
Buildings	239,997	239,998
Building improvements	183,538	200,336
Leasehold improvements	194,312	231,225
Furniture, fixtures and equipment	582,706	565,750
	1,432,268	1,469,024
Less allowances for depreciation and amortization	507,070	539,328
	$ 925,198	929,696

Generally, the estimated useful lives used for computing depreciation range from 20 to 33 years for buildings, 4 to 14 years for furniture, fixtures and equipment and the life of the lease for leasehold improvements.

(9) Debt

Under a line of credit arrangement for short-term debt, Associated may borrow up to $4,000,000 on such terms as it and the bank may mutually agree upon. The line of credit can be withdrawn at the bank's option. There were no compensating balance arrangements under the line of credit nor any outstanding borrowings at any month end during the two years ended January 31, 1976.

(Continued)

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In November 1975 the Company entered into a line of credit arrangement with the Maryland National Bank for short-term debt under which arrangement the Company could borrow up to $750,000 on such terms as the Company and the bank mutually agreed upon. There were outstanding borrowings under this arrangement of $250,000 at December 31, 1975 and $350,000 at January 31, 1976. Subsequent to that date borrowings under the arrangement increased to $650,000 with the latter amount refunded, and this credit arrangement replaced, by a bank term loan. See note 16. The average interest rate was 8.37% for borrowings under this line of credit during the year ended January 31, 1976. There were no compensating balance arrangements supporting the line; shares of Berkshire Hathaway Inc. were pledged as collateral for borrowings thereunder.

8% Debentures

The debentures were issued under a trust indenture dated November 1, 1967, under which the aggregate principal amount which may be issued is unlimited, the debentures are not secured by any lien, and there are no restrictions against secured or unsecured borrowings of the Company. They bear interest at a fixed annual rate of 8% payable semiannually and bear participating additional interest each year up to a maximum of 1% contingent upon the amount of adjusted consolidated earnings before income taxes, as defined, for the previous fiscal year. No contingent interest was payable under these provisions during the last two fiscal years.

The debentures are subject to redemption at the option of the Company at 104% of par plus accrued interest to October 31, 1976 and thereafter at percentages reducing to 100% at November 1, 1983. The debentures are also contingently subject to redemption at par plus accrued interest through operation of a sinking fund. If the adjusted consolidated net worth, as defined, of the Company is less than $12 million, sinking fund payments are generally required. No such contingent sinking fund payments have been required and none appear imminent.

The debentures are further subject to redemption at the option of each debenture holder, exercisable within 60 days following notice that, other than by reason of the death of Warren E. Buffett, said Warren E. Buffett or an organization controlled by him, shall cease to own in combined holdings a larger block of shares with voting rights of the Company than any other stockholder, or combination of stockholders, controlled by a single individual.

The articles of incorporation of the Company provide that if and as long as an event of default exists or the adjusted consolidated net worth of the Company is less than $8,000,000, and either condition continues for a period of thirty days, then the holders of the debentures, to the exclusion of the holders of the Company's stock, shall be entitled to vote (i) to elect directors of the Company, and (ii) to approve the sale, lease or other disposition of all or substantially all of the assets of the Company and distribution of the proceeds thereof to the extent necessary to pay all sums due debenture holders and other creditors. No amendment to such provisions shall be made as long as any debentures are outstanding without the written approval of the holders of two-thirds in principal amount of

(Continued)

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the debentures then outstanding. If there are such voting rights, each holder of the debentures will have one vote for each $1,000 principal amount of debentures.

The trust indenture covering the debentures contains certain restrictions applicable to the Company relating to net worth, redemption of stock and payment of dividends. Retained earnings of approximately $1,303,000 were subject to such restrictions at January 31, 1976.

9% Notes Payable

The notes payable represent purchase obligations for shares of Berkshire Hathaway Inc. acquired at various dates. These notes become due at varying dates through January 4, 1988 and bear interest at 9% per year, payable semiannually. The notes are also due on the respective payees' demand on or after the expiration of twelve months following the date of death of Warren E. Buffett.

Principal payments due on these notes are summarized by fiscal year as follows:

1977	$ 83,231
1978 through 1980	3,731
1981	28,731
1982	357,969
1983	571,299
1986	165,286
1987	26,500
1988	128,500

(10) Income Taxes

Total income tax expense for the years ended February 1, 1975 and January 31, 1976 is summarized as follows:

	Year ended	
	Feb. 1, 1975	Jan. 31, 1976
Income taxes applicable to:		
Operating earnings	$ 306,796	488,969
Equity in earnings of Berkshire Hathaway Inc.	56,712	48,473
Equity in earnings of Blue Chip Stamps	101,248	106,080
Realized gain (loss) on sales of securities	(89,894)	2,017
Extraordinary gain	36,000	-
Total income tax expense	$ 410,862	645,539

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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	Year ended Feb. 1,1975	Year ended Jan.31,1976
Current taxes applicable to:		
Operating earnings	$ 309,196	542,859
Distributed earnings of Blue Chip Stamps	14,548	14,548
Realized investment gain (loss)	106	(87,983)
Extraordinary gain	36,000	-
Total current	359,850	469,424
Deferred taxes applicable to:		
Equity in undistributed earnings of:		
Berkshire Hathaway Inc.	56,712	48,473
Blue Chip Stamps	86,700	91,532
Accreted discount on bonds	1,900	9,950
Credit for tax effect of reduction in insurance companies' deferred acquisition costs	(4,300)	(63,840)
Reversal of (provision for) anticipated loss on sale of investment securities	(90,000)	90,000
Total deferred	51,012	176,115
	$ 410,862	645,539
The above figures represent:		
State and local income taxes	174,000	226,150
Federal income taxes	236,862	419,389
	$ 410,862	645,539

Federal income taxes computed at the statutory 48% rate applied to income before taxes are reconciled to the Federal income tax expense figures reflected above as follows:

	Year ended Feb. 1,1975	Year ended Jan.31,1976
Federal income taxes at statutory rate	$ 1,082,000	1,302,000
Tax differences relating to:		
Dividends received credits, including credits applied to equity in earnings of Berkshire Hathaway Inc. and Blue Chip Stamps	(918,000)	(896,000)
Amortization of differences between cost and underlying net assets of subsidiaries and investees (not deductible for tax purposes)	167,000	157,000
Capital gain or loss rate differential	31,000	(1,000)
State and local taxes, net of Federal tax benefit	90,000	118,000
Tax-exempt interest income	(39,000)	(48,000)
All other	(2,138)	13,539
	$ 410,862	645,539

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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(11) Stockholders' Equity

There were no changes in the capital stock and additional paid-in capital accounts during the two years ended January 31, 1976.

At January 31, 1976 consolidated retained earnings included $7,342,284 representing undistributed earnings of affiliated companies (net of income tax provisions) as follows: Berkshire Hathaway - $3,934,908; Blue Chip - $3,407,376.

At January 31, 1976, the parent Company's retained earnings included $423,197 representing undistributed earnings of Associated and $1,271,111 representing undistributed earnings of Berkshire Hathaway Inc.

(12) Leases

Associated and its retailing subsidiaries lease 67 stores, warehouse facilities and New York offices, under leases expiring at various dates through 1988. The leases require minimum annual rentals plus, under the terms of certain leases, additional payments for taxes, other expenses and percentage rentals. Total rental expense on such facilities for the fiscal years ended February 1, 1975 and January 31, 1976 was approximately $1,788,000 and $1,782,000, respectively, including contingent rentals of approximately $213,000 and $287,000, respectively.

The present value of noncapitalized financing leases is not material. Likewise, the impact on net income if such leases had been capitalized would not be material.

Minimum annual rental obligations under the existing real estate leases were as follows:

Fiscal year ending 1977	$ 1,317,000
Fiscal year ending 1978	1,118,000
Fiscal year ending 1979	930,000
Fiscal year ending 1980	819,000
Fiscal year ending 1981	731,000
Fiscal years ending 1982-1986	2,115,000
Fiscal years ending 1987-1988	33,000
Total	$ 7,063,000

(13) Pension Plan

Associated has a noncontributory trusteed pension plan covering eligible full-time employees. The total pension expense for the fiscal years ended February 1, 1975 and January 31, 1976 was $73,000 and $7,800, respectively. The expense for 1975 included normal cost and amortization of past service liability over a thirty year period. The expense for 1976 relates only to interest since the provisions and certain assumptions of the plan were in the process of being revised. Management believes the effect of the revisions will be a relative reduction in normal cost of the plan. The unfunded past service liability at February 1, 1975 (date of last valuation) was approximately $100,000.

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DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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(14) Extraordinary Items

In May 1973 Associated Retail Stores, Inc. received condemnation proceeds of approximately $1,348,000 for certain real estate improvements which were reflected on the books at $874,000, net of depreciation allowance. It was estimated that an additional $135,000 would be realized from this proceeding; the latter amount was recognized in computing gain of $395,578 net of $213,000 income taxes, reflected as an extraordinary item in the statement of earnings for the year ended February 2, 1974. Proceeds over and above the $135,000 estimated as of February 2, 1974 were received in connection with those properties in the current fiscal year, and an additional gain of $68,391, net of $35,000 income taxes, is reflected as an extraordinary item in the statement of earnings for the year ended February 1, 1975.

(15) Supplemental Note - Inventories

Inventories used in the computation of cost of goods sold were as follows:

February 2, 1974	$ 4,313,442
February 1, 1975	4,220,012
January 31, 1976	4,739,021

(16) Commitment and Subsequent Event

In March and April 1976 the Company repurchased for cash 211,877 shares of its outstanding capital stock for an aggregate purchase price of $3,178,155. Proceeds of a bank term loan, described in the succeeding paragraph, were the source of funds used for the repurchase.

In March 1976, the Company arranged for a bank term loan of principal amount of $4,000,000, fully drawn down in April of 1976, repayable in principal installments of $1,000,000 on March 1, 1979 and March 1, 1980 and $2,000,000 on March 1, 1981. Interest on this loan will fluctuate at 2% over the Maryland National Bank prime rate. This loan refunded $650,000 short-term borrowings from the bank and the loan agreement replaced the short-term debt line of credit agreement disclosed in note 9 preceding. Collateral pledged by the parent Company will include 98,900 shares or more of Berkshire Hathaway Inc., 453,000 shares of Associated Retail Stores, Inc. and a $6,600,000 promissory note of Associated to Diversified, due in 1985. Negative covenants supporting the loan preclude (1) additional long-term borrowings by the Company or its subsidiaries, (2) additional pledge of assets by the Company or its subsidiaries, (3) payment of dividends by the Company, and (4) changes in the investment structure of the Company or its subsidiaries particularly with reference to the 841,900 share holdings of Blue Chip Stamps. An event of default against the 8% debentures due 1985 of the Company will constitute an event of default under this borrowing. Further, the lending bank would consider it an event of default for Diversified to be merged, sold or transferred in any way to any other company not effectively controlled by Warren Buffett.

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Notes to Financial Statements

(17) Transactions With Affiliates

Columbia derives the major portion of its business through the assumption of reinsurance contracts from insurance subsidiaries of Berkshire Hathaway Inc. The amounts included in the consolidated financial statements that relate to such transactions are as follows:

	1975	1976
Earned premiums	$ 1,839,304	2,156,605
Unearned premiums	919,958	1,084,890
Incurred losses and loss adjustment expenses	1,433,643	1,734,849
Commissions	554,626	524,009

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Investment in Securities of Affiliates

Schedule III

Name of issuer and description of issue	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount in dollars	Additions: Equity taken up to earnings	Additions: Other: Amount	Additions: Other: Description	Deductions: Dividends	Deductions: Other: Amount	Deductions: Other: Description	Balance at close of period: Number of shares	Balance at close of period: Amount
Year ended February 1, 1975:										
Affiliates:										
Blue Chip Stamps common stock	841,900	$ 12,490,857	960,259			202,056			841,900	$ 13,249,060
Berkshire Hathaway Inc. common stock	109,551	9,405,391	779,385						109,551	10,184,776
		$ 21,896,248	1,739,644			202,056				23,433,836
Year ended January 31, 1976:										
Affiliates:										
Blue Chip Stamps common stock	841,900	13,249,060	1,027,611			202,056	810,000	Equity in net unrealized loss on marketable equity securities	841,900	13,264,615
Berkshire Hathaway Inc. common stock	109,551	10,184,776	685,591	1,771,442	Acquisition of 38,064 shares				147,615	12,641,809
		$ 23,433,836	1,713,202	1,771,442		202,056	810,000			25,906,424

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Investment in Securities of Affiliates

Schedule III

Name of issuer and description of issue	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount in dollars	Additions: Equity taken up to earnings	Additions: Other Amount	Deductions: Dividends	Deductions: Other Amount	Balance at close of period: Number of shares	Balance at close of period: Amount
Year ended February 1, 1975:								
Associated Retail Stores, Inc.	453,000	$ 20,394,648	1,630,378				453,000	$ 22,025,026
Affiliate - Berkshire Hathaway Inc. common stock	26,392	$ 2,057,355	193,463				26,392	$ 2,250,818
Year ended January 31, 1976:								
Associated Retail Stores, Inc.	453,000	$ 22,025,026	1,744,319		4,788,757 (1)	839,303 (2)	453,000	$ 18,141,285
Affiliate - Berkshire Hathaway Inc. common stock	26,392	$ 2,250,818	301,819	478,635 (3) 4,854,924 (4) 5,333,559			98,900	$ 7,886,196

(1) Dividend consisting of stock in affiliate.
(2) Equity in net unrealized loss on marketable equity securities.
(3) Acquisition of 11,098 shares.
(4) Dividend from subsidiary.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Supplementary Income Statement Information

Schedule XVI

Item	Charged to costs and expenses
Fiscal year ended February 1, 1975:	
Maintenance and repairs	$ 452,812
Taxes, other than income taxes:	
Payroll taxes	485,893
Personal property and real estate	200,959
Other	141,461
Rents:	
Real estate	1,787,789
Equipment	85,099
Fiscal year ended January 31, 1976:	
Maintenance and repairs	526,557
Taxes, other than income taxes:	
Payroll taxes	498,853
Personal property and real estate	244,588
Other	111,258
Rents:	
Real estate	1,782,208
Equipment	75,456

PEAT, MARWICK, MITCHELL & CO.

CERTIFIED PUBLIC ACCOUNTANTS

ACCOUNTANTS' REPORT

The Board of Directors
Columbia Insurance Company:

We have examined the consolidated financial statements and related schedules of Columbia Insurance Company and consolidated subsidiary as listed in the accompanying index. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an affiliated company. The Company's investment in Blue Chip Stamps at December 31, 1974 and 1975 was $3,871,969 and $3,852,636, respectively, and its equity in earnings of Blue Chip Stamps was $231,647 and $250,167 for the respective years then ended. The financial statements of Blue Chip Stamps were examined by other auditors whose qualified report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Blue Chip Stamps, is based solely upon the report of the other auditors.

The report of the other auditors on the financial statements of Blue Chip Stamps for the year ended February 28, 1976 was qualified with respect to the outcome of certain legal proceedings. These legal proceedings are explained in note 7 of notes to the consolidated financial statements.

In our opinion, based upon our examination and the report of the other auditors and subject to the effect, if any, upon the investment in Blue Chip Stamps resulting from the ultimate outcome of the legal proceedings referred to in the preceding paragraph, the aforementioned consolidated financial statements present fairly the financial position of Columbia Insurance Company and consolidated subsidiary at December 31, 1974 and 1975 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis except for the change, with which we concur, in the valuation of marketable equity securities, as described in note 1 of notes to consolidated financial statements; and the supporting schedules, in our opinion, subject to the effect of the matter discussed in the preceding paragraph, present fairly the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.

Peat, Marwick, Mitchell & Co.

Omaha, Nebraska
April 15, 1976

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Balance Sheets

December 31, 1974 and 1975

Assets	1974	1975
Investments - other than affiliates (notes 3 and 4) (Schedule I):		
U. S. Treasury Bills, at cost which approximates market	$ 1,806,004	2,421,690
Bonds, at amortized value	1,788,450	2,199,877
Common stocks at cost, 1974; market, 1975	1,221,755	533,833
Total investments, other than affiliates	4,816,209	5,155,400
Cash	124,828	59,092
Investment in Berkshire Hathaway Inc. (note 5) (Schedule II)	4,525,465	4,755,613
Investment in Blue Chip Stamps (notes 6 and 7) (Schedule II)	3,871,969	3,852,636
Investment income due and accrued	34,996	43,298
Uncollected premiums	581,865	185,910
Reinsurance recoverable on loss payments	26,241	-
Prepaid acquisition costs	133,000	-
Income taxes recoverable from parent (note 8)	42,844	218,000
Excess of cost over net assets of subsidiary purchased, net of accumulated amortization of $24,255 in 1974 and $48,405 in 1975	48,300	24,150
Other assets	72,662	70,548
	$ 14,278,379	14,364,647

Liabilities, Capital Stock and Surplus	1974	1975
Losses and loss adjustment expenses	$ 3,414,588	4,019,020
Unearned premiums	1,224,835	1,116,749
Assumed losses payable	315,412	-
Ceded reinsurance balances payable	163,418	-
Amounts retained by company for account of others	220,118	155,933
Deferred income taxes (note 8)	182,403	262,496
Other liabilities	59,771	25,888
Total liabilities	5,580,545	5,580,086
Capital stock and surplus:		
Capital stock par value $100. Authorized, issued and outstanding, December 31, 1974 and 1975 - 20,000 shares	2,000,000	2,000,000
Surplus:		
Paid-in	3,855,389	3,855,389
Net unrealized loss on marketable equity securities (notes 4 and 6)	-	(270,303)
Unassigned (note 14)	2,842,445	3,199,475
Total surplus	6,697,834	6,784,561
Total capital stock and surplus	8,697,834	8,784,561
	$ 14,278,379	14,364,647

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Earnings

Years ended December 31, 1974 and 1975

	1974	1975
Premiums:		
Premiums written	$ 3,175,412	2,713,246
Decrease (increase) in unearned premiums	(321,942)	173,075
Premiums earned (note 15) (Schedule VII)	2,853,470	2,886,321
Investment income, net (note 10)	220,182	282,346
	3,073,652	3,168,667
Losses and claims incurred (note 15) (Schedule VII)	2,139,325	2,325,427
Loss adjustment expenses (note 15)	315,222	340,086
Underwriting expenses (notes 11 and 15)	773,144	802,682
	3,227,691	3,468,195
Loss before income taxes, equity in earnings of other companies and realized investment gains and losses	154,039	299,528
Income taxes (benefit) (note 8):		
Current	(76,648)	(134,445)
Deferred	(2,400)	(53,890)
	(79,048)	(188,335)
Loss before equity in earnings of other companies and realized investment gains and losses	74,991	111,193
Equity in earnings of other companies:		
Berkshire Hathaway Inc. (note 5)	321,877	213,346
Blue Chip Stamps (note 6)	231,647	250,167
	553,524	463,513
Earnings before realized investment gains and losses	478,533	352,320
Investment gains (losses) - excludes unrealized appreciation in common stocks of unaffiliated companies of $128,623 in 1974 and $44,228 in 1975:		
Realized investment gains (losses) (notes 4 and 12)	(299,648)	6,727
Applicable income taxes (benefit) (note 8)	(89,894)	2,017
Net realized investment gains (losses)	(209,754)	4,710
Net earnings	$ 268,779	357,030

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Capital Stock and Surplus

Years ended December 31, 1974 and 1975

		Surplus		
	Capital stock	Paid-in	Net unrealized loss on marketable equity securities	Unassigned
Balance, December 31, 1973	$ 2,000,000	3,855,389	-	2,573,666
Net earnings for the year	-	-	-	268,779
Balance, December 31, 1974	2,000,000	3,855,389	-	2,842,445
Net earnings for the year	-	-	-	357,030
Unrealized losses in common stock investments in unaffiliated companies	-	-	(29,303)	-
Unrealized losses in common stock portfolio of investee	-	-	(241,000)	-
Balance, December 31, 1975	$ 2,000,000	3,855,389	(270,303)	3,199,475

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1974 and 1975

	1974	1975
Funds provided:		
From operations:		
Net earnings	$ 268,779	357,030
Charges (credits) to earnings not requiring (providing) funds:		
Accretion of bond discount	(5,330)	(21,063)
Increase in estimated losses and loss adjustment expenses	1,070,058	604,432
Increase (decrease) in unearned premiums	321,942	(108,086)
Increase (decrease) in assumed losses payable	54,801	(315,412)
Increase (decrease) in deferred taxes	(92,400)	36,111
Increase in income taxes recoverable from parent	(42,844)	(175,156)
Increase in accrued taxes and expenses	19,934	-
Decrease (increase) in uncollected premiums	(158,877)	395,955
Decrease (increase) in accrued investment income	1,370	(8,302)
Decrease in prepaid acquisition costs	9,000	133,000
Loss (gain) on sale of investments	(352)	293,273
Provision for (recovery of) anticipated losses on common stocks	300,000	(300,000)
Equity in undistributed earnings of affiliated companies, net of deferred taxes	(497,844)	(407,833)
Amortization	24,411	24,150
Increase (decrease) in ceded balances payable	160,216	(163,418)
Decrease (increase) in reinsurance recoverable on loss payment	(26,241)	26,241
Funds provided from operations	1,406,623	370,922
From sale of bonds	-	203,887
From sale of common stock investments in unaffiliated companies	30,638	659,364
Decrease in cash	372,862	65,736
Other, net	31,817	(31,769)
Total funds provided	$ 1,841,940	1,268,140
Funds used:		
Subsidiary acquired:		
Securities	703,893	-
Cash	484,082	-
Other assets	105,347	-
Excess of cost over net assets acquired	72,555	-
Estimated loss and loss adjustment expenses	(684,019)	-
Other liabilities	(184,058)	-
	497,800	-
Cost of investments purchased:		
Increase in U. S. Treasury Bills	1,143,415	615,686
Bonds	185,725	588,269
Common stocks of unaffiliated companies	15,000	-
	1,344,140	1,203,955
Decrease in amounts retained by company for account of others	-	64,185
Total funds used	$ 1,841,940	1,268,140

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1974 and 1975

(1) Summary of Significant Accounting Policies and Practices

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its 99.6% owned subsidiary, Southern Casualty Insurance Company. The subsidiary was acquired April 30, 1974 and since such acquisition was accounted for as a purchase, the results of operations for the subsidiary are included in the consolidated statements of earnings only for the period subsequent to the date of acquisition. The excess of cost over the underlying net assets at the date of acquisition is being amortized over approximately three years using the straight-line method. All significant intercompany accounts and transactions have been eliminated in consolidation.

(b) Investment in Securities, Other than Affiliates

Investments in bonds are stated at cost, adjusted where appropriate for amortization of premium or accretion of discount. The aggregate market value of bonds has not been determined but such market value would be less than amortized cost. No provision has been made for possible losses on such bonds since the companies intend to hold the bonds to maturity and do not expect to realize any significant losses.

Investments in common stocks are stated at cost less a valuation allowance for anticipated losses in 1974 and at the lower of aggregate cost or market in 1975. This change in accounting method was made pursuant to the dictates of Statement of Financial Accounting Standards No. 12. The reduction from cost to market value is reflected as a direct charge to surplus. In addition, the Company has reflected a direct charge to surplus representing its share of the unrealized loss that existed at February 28, 1976 in the marketable equity securities owned by an investee. No tax effect has been recognized with respect to these unrealized losses.

The basis of investment securities sold is determined generally on a first-in, first-out method.

(c) Investment in Affiliated Companies

The Company holds common stock investments in Berkshire Hathaway Inc. and Blue Chip Stamps, which two companies are considered "investees" under the provisions of Accounting Principles Board Opinion No. 18. Accordingly, the Company uses the equity method of accounting for these investments, under which method the Company currently recognized its proportionate share of earnings reported by those companies, net of deferred income taxes provided for under the assumption that such earnings will ultimately be distributed as taxable dividends. Provision is also made for amortization of the difference between cost of the investments and the underlying equity in net assets at the dates of acquisition; this provision is computed on the basis of a forty year amortization period for the investment in Berkshire Hathaway Inc. and a period of seven years for the investment in Blue Chip Stamps.

Blue Chip Stamps determines income on the basis of a fiscal year ending on or about February 28; the Company has not recognized this difference in its annual accounting for its equity in earnings of Blue Chip, having recorded its equity in earnings of Blue Chip's year ending with respect to February 28 in its year ending with respect to the preceding December 31.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(d) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the terms of the policies. Unearned premiums are computed on the monthly pro rata basis. Policy acquisition costs or commissions are deferred and charged against income ratably over the terms of the policies.

(e) Estimated Losses

The provision for losses and loss adjustment expenses is based upon past experience and estimates received relating to assumed reinsurance and estimates of unreported losses.

(f) Income Taxes

The Company accounts for certain income and expense items differently for financial reporting purposes than for income tax purposes. Provisions for deferred taxes are being made in recognition of these timing differences.

The companies join Associated Retail Stores, Inc., the parent of Columbia Insurance Company, in filing consolidated income tax returns.

(2) Basis of Presentation

The consolidated financial statements of Columbia Insurance Company and subsidiary are presented in accordance with generally accepted accounting principles (GAAP) which differ in some respects from principles prescribed or permitted by insurance regulatory authorities (statutory methods) in accordance with which the Company maintains it records. A reconciliation of the aggregate capital stock and surplus ("Surplus as regards Policyholders") as determined under the statutory method to that determined and reported herewith in accordance with GAAP is as follows:

	December 31, 1974	December 31, 1975
Statutory surplus as regards policyholders	$ 3,350,488	3,683,601
Excess of cost valuations over NAIC market valuations of investments in equity securities other than affiliates	372,055	-
Excess of carrying values of investments in affiliates (determined under GAAP pursuant to the equity method) over NAIC market valuation:		
Berkshire Hathaway Inc.	2,333,290	2,807,013
Blue Chip Stamps	2,559,469	2,290,136
Deferred insurance premium acquisition costs	133,000	-
Excess statutory liability loss reserves	33,215	10,674
Excess of cost over net assets of subsidiary purchased	48,300	24,150
Sundry nonadmitted assets	6,273	12,400
Recoverable income taxes from parent Company	42,844	218,000
Income tax effect and adjustments	(181,100)	(261,413)
Capital stock and surplus per accompanying financial statements	$ 8,697,834	8,784,561

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

Statutory net loss is reconciled to GAAP net earnings as follows:

	1974	1975
Statutory net loss	$ (60,576)	(375,543)
Decrease in deferred acquisition costs	(9,000)	(133,000)
Amortization of excess cost of investment in Southern Casualty Insurance Company	(24,255)	(24,150)
Equity in undistributed earnings of affiliates:		
Berkshire Hathaway Inc.	321,877	213,346
Blue Chip Stamps	171,647	190,167
Realized loss on common stocks other than affiliates	(300,000)	300,000
Recoverable income taxes from parent company	72,366	218,000
Income tax effects and adjustments	96,720	(31,790)
Net earnings per accompanying financial statements	$ 268,779	357,030

(3) Securities Deposited with Others

Certain bonds and stocks deposited in trust with regulatory authorities or with ceding reinsurers in accordance with various reinsurance treaties were as follows:

	1974	1975
Bonds, at amortized cost	$ 1,065,551	973,050
Stocks, cost	2,041,042	3,079,663
	$ 3,106,593	4,052,713

(4) Investments - Other than Affiliates

The Company recognized a $300,000 provision for anticipated losses on common stocks of unaffiliated companies as a realized investment loss in 1974. Accordingly, the investment in such stocks is reported at cost less the allowance for anticipated losses. The investment in common stocks of unaffiliated companies and the related market values are as follows:

	1974	1975
Cost	$ 1,521,755	563,136
Allowance for anticipated losses	(300,000)	-
Net unrealized loss	-	(29,303)
Carrying value	$ 1,221,755	533,833
Approximate market value	$ 849,700	533,833

At December 31, 1975 gross unrealized gains were $6,376 and gross unrealized losses were $35,679. A net realized gain of $6,727 (before applicable income taxes) on the sale of securities was included in the determination of net earnings for 1975.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

Investments, other than investments in U. S. Treasury Bills, comprising greater than two percent of total investments were as follows at December 31, 1974 and 1975:

Common stocks	Cost	Market value
1974:		
California Water Service Company	$ 275,447	259,957
Omaha National Corporation	118,640	132,000
Morse Shoe, Inc.	153,100	45,000
Vornado, Inc.	660,052	216,000
1975:		
California Water Service Company	$ 275,447	279,315
Omaha National Corporation	118,640	123,200

Bonds	Amortized cost	Par value
1974:		
Alabama, Montgomery Industrial Revenue, 7-1/4%, 1989	$ 100,000	100,000
Arkansas, Danville Industrial Revenue, 7-1/4%, 1991	105,000	105,000
Georgia, Washington-Wilkes Payroll Development Authority, 7-3/4%, 1989	100,000	100,000
Illinois Toll Road Commission, 3-3/4%, 1995	97,377	125,000
Indiana Toll Road Commission, 3-1/2%, 1994	101,611	150,000
Iowa, Burlington Industrial Revenue, 7-1/4%, 1991	99,175	100,000
Kansas, Lenexa Industrial Revenue, 8.85%, 1987	100,000	100,000
Missouri, Rolla Industrial Revenue, 8%, 1984	96,629	100,000
FMC Corporation, 4-1/4%, 1992	143,202	200,000
1975:		
Alabama, Camden Industrial Revenue	$ 137,368	137,368
Arkansas, Danville Industrial Revenue, 7-1/4%, 1991	105,000	105,000
Indiana Toll Road Commission, 3-1/2%, 1994	104,157	150,000
Texas, Nueces Pollution Control Revenue, 9%, 1990	149,628	149,628
Chrysler Financial Corporation, various issues	297,159	440,000
FMC Corporation, 4-1/4%, 1992	143,202	200,000

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(5) Investment in Berkshire Hathaway Inc.

The carrying value of the investment in common stock of Berkshire Hathaway Inc. represents the cost plus the equity in earnings since dates of acquisition, adjusted for amortization on a forty year basis of the excess cost over underlying net asset values at dates of acquisition. This is summarized as follows:

	December 31, 1974	December 31, 1975
Shares owned	48,715	48,715
Percentage of total outstanding shares (approximate)	5%	5%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 2,668,740	2,668,740
Excess cost, net of amortization of $7,406 at December 31, 1974 and $10,599 at December 31, 1975	120,363	117,170
	2,789,103	2,785,910
Equity in post-acquisition earnings	1,736,362	1,969,703
Carrying value	$ 4,525,465	4,755,613

Deferred income taxes of approximately $125,000 at December 31, 1974 and $142,000 at December 31, 1975 have been provided with respect to the equity in post-acquisition earnings, assuming their ultimate distribution as a taxable dividend.

(6) Investment in Blue Chip Stamps

The carrying value of the investment in 250,000 shares of common stock of Blue Chip Stamps (approximately 5% of the total outstanding shares) represents the cost plus the equity in undistributed earnings since dates of acquisition, adjusted for amortization of the excess cost over underlying net asset values at dates of acquisition. This is summarized as follows:

	December 31, 1974	December 31, 1975
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 1,912,829	1,912,829
Excess cost, net of amortization of $351,478 at December 31, 1974 and $507,311 at December 31, 1975	836,568	680,735
	2,749,397	2,593,564
Equity in post-acquisition undistributed earnings	1,122,572	1,500,072
Excess of cost over market value of Blue Chip Stamps' marketable equity securities at February 28, 1976 applicable to the Company's equity interest	-	(241,000)
Carrying value	$ 3,871,969	3,852,636

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

Commencing with 1973, the excess cost over underlying net asset values is being written off over a seven year period.

Deferred income taxes of approximately $81,000 at December 31, 1974 and $108,000 at December 31, 1975 have been provided with respect to the equity in post-acquisition undistributed earnings, assuming their ultimate distribution as a taxable dividend.

Dividends of $60,000 in 1975 and 1974 were received from Blue Chip Stamps.

(7) Legal Proceedings of Blue Chip Stamps

The financial statements of Blue Chip Stamps include the following note (The "Company" refers to Blue Chip Stamps):

"Pursuant to an antitrust action filed by the Federal Government a consent final judgment was entered in 1967 providing for, among other things, a plan to offer for sale one-third of the Company's California trading stamp business located within a contiguous geographical area in Southern California. That portion of the judgment has been suspended indefinitely by stipulation and court order signed in March 1976.

The Company is a defendant in a purported class action filed March 1, 1971 to recover for stamp savers monies collected by it as reimbursement for California sales taxes on redemption of stamps. Plaintiffs claim that redemption transactions are not taxable and that all such collections should be returned or, alternatively, that such collections exceeded the tax properly payable and such excess should be returned. The Company has paid sales taxes to the state equal to its reimbursement collections. The Company has asserted claims against the state for reimbursement of all or part of any recovery by plaintiffs. Following denial of these claims by the state, the Company cross-complained against the state seeking indemnity. The original class action complaint against the Company was amended to assert fraud and to seek punitive damages. On June 1, 1973 two partial summary judgments were entered by way of interlocutory orders, neither of which has yet become final. The first was in favor of the Company to the effect that the redemption transactions were taxable. The second was in favor of plaintiffs to the effect that the Company's collections exceeded the tax properly payable. In the opinion of counsel for the Company, the second partial summary judgment was erroneous. The class action complaint was also amended effective September 19, 1974 to assert, in substance, that the Company's predecessor had engaged in similar conduct from 1961 until its merger into the Company in 1968, and that the Company must respond in respect of the alleged liability of its predecessor to plaintiffs and the persons they purport to represent for overreimbursement of sales taxes. On October 24, 1975 the California Supreme Court granted the petition of Blue Chip Stamps for an alternative writ of mandate to determine (1) whether the trial court properly certified the action as a class action and set it for trial

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

without any notice to members of the purported class and (2) whether or not an order for partial summary judgment previously entered was erroneous. Proceedings in the trial court are stayed pending final determination of the mandate proceedings in the California Supreme Court. Issues relating to the class action aspects of the case remain unresolved along with a number of issues of fact. Maximum liability in respect of this action as amended may be as high as $17,000,000 less the amount of any money which may be recovered on the claims against the state. Counsel believes the prospects for some such recovery to be good. In the opinion of counsel for the Company, substantial defenses are available, but counsel cannot predict the ultimate outcome of the action.

A purported class action was filed under Federal securities laws on November 10, 1970 against the Company and certain of its present and former stockholders and directors, on behalf of retailer users of Blue Chip Stamps who failed to purchase securities of the Company in a 1968 offering to retailer users. The complaint alleged damages to plaintiffs of $21,400,000, together with exemplary damages of $25,000,000, interest, attorneys' fees and costs, and prayed that plaintiffs have the right to purchase securities of the Company on the terms of the 1968 offering. After hearings in the United States District Court and the United States Court of Appeals for the Ninth Circuit, the Supreme Court of the United States in a decision rendered on June 9, 1975 held that the purported class did not have standing to bring such an action. Accordingly, the Federal action is concluded. On June 5, 1974 the Company was served with a complaint in a substantially identical action based on California corporate and common law filed in Los Angeles County Superior Court on June 21, 1971. Although plaintiffs are pursuing the state court action, in the opinion of counsel for the Company, upon the facts now known, the present state of the law and the decision of the Supreme Court in the Federal action, there appear to be substantial defenses on the merits."

(8) Income Taxes

Income tax expense (benefit) is made up of the following:

	1974	1975
Totals:		
Benefit applicable to operating earnings	$ (79,048)	(188,335)
Expense applicable to equity in earnings of:		
Berkshire Hathaway Inc.	25,220	16,803
Blue Chip Stamps	30,021	31,500
Expense (benefit) applicable to investment losses	(89,894)	2,017
	$(113,701)	(138,015)

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

	1974	1975
Income tax currently payable (recoverable) relating to:		
Loss before income taxes, equity in earnings of other companies and realized investment gain (loss)	$ (76,648)	(134,445)
Distributed earnings of Blue Chip Stamps	4,320	4,320
Realized investment gain (loss)	106	(87,983)
Total current	(72,222)	(218,108)
Deferred expense (credit) relating to:		
Equity in undistributed earnings of other companies:		
Berkshire Hathaway Inc.	25,220	16,803
Blue Chip Stamps	25,701	27,180
Accreted discount on bonds	1,900	9,950
Credit for tax effect of reduction in deferred acquisition costs	(4,300)	(63,840)
Recovery of (provision for) anticipated loss on sale of investment securities	(90,000)	90,000
Total deferred	(41,479)	80,093
Total income tax credit	$ 113,701	138,015

Total net income after taking into account realized investment losses but before income taxes was $155,078 in 1974 and $219,015 in 1975. Income tax expense of $74,437 in 1974 and $105,127 in 1975 would result if computed by applying the statutory U. S. Federal income tax rate of 48% to income before taxes. The differences are reconciled as follows:

	1974	1975
Tax expense at statutory rate	$ 74,437	105,127
Increase (reduction) in income taxes resulting from:		
Tax-exempt interest	(39,138)	(48,156)
85% dividends received credit relating to:		
Dividends received from unaffiliated companies	(23,159)	(20,653)
Equity in net earnings of other companies	(313,247)	(273,702)
Amortization of cost in excess of the underlying equity in net assets of affiliated companies and subsidiary	87,961	87,913
Capital loss rate differential	53,937	1,211
Tax benefit to parent in consolidation	43,481	-
Other	2,027	10,245
Total income tax credit	$ 113,701	138,015

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(9) Transactions with Affiliates

The Company derives the major portion of its business through the assumption of reinsurance contracts from insurance subsidiaries of Berkshire Hathaway Inc. The amounts included in the financial statements relating to such transactions are as follows:

	December 31, 1974	December 31, 1975
Earned premiums	$ 1,839,304	2,156,605
Unearned premiums	919,958	1,084,890
Incurred losses and loss adjustment expenses	1,433,643	1,734,849
Commissions	554,626	524,009

(10) Investment Income, Net

Investment income is comprised of the following:

	1974	1975
Interest on bonds	$ 191,864	262,265
Dividends, unaffiliated companies	56,762	50,619
	248,626	312,884
Investment expenses	28,444	30,538
Net investment income	$ 220,182	282,346

(11) Underwriting Expenses

The following expenses made up underwriting expenses:

	1974	1975
Commissions and brokerage	$ 652,490	506,173
Taxes, licenses and fees	47,457	50,083
Other underwriting expenses	64,197	113,426
Decrease in prepaid acquisition costs	9,000	133,000
	$ 773,144	802,682

(12) Investment Gains and Losses

A summary of realized and unrealized investment gains (losses) for 1974 and 1975 follows:

	1974			
	Gross	Applicable tax	Net	Unrealized
Common stocks	$ 352	(106)	246	128,623
Provision for anticipated losses	(300,000)	90,000	(210,000)	-
	$(299,648)	89,894	(209,754)	128,623

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

	1975			
	Gross	Applicable tax	Net	Unrealized
Bonds	$ 5,982	(1,795)	4,187	-
Common stocks	(299,255)	89,778	(209,477)	44,228
Recovery of provision for anticipated losses	300,000	(90,000)	210,000	-
	$ 6,727	(2,017)	4,710	44,228

(13) Reinsurance

Amounts stated in the accompanying financial statements are net of reinsurance ceded. The following summarizes the amounts deducted from certain liability, income and expense accounts in connection with reinsurance ceded:

	1974	1975
Estimated losses and loss adjustment expenses	$ 148,983	181,773
Premiums written	427,778	784,052
Losses paid	273,721	525,625

(14) Stockholder's Equity

Surplus is restricted for dividend purposes by the insurance departments of the states in which the companies do business.

(15) Change in Recording Reinsurance Transactions

During 1975 the Company changed its procedures for recording reinsurance business assumed from other companies. Due to the time lag in receiving reports from ceding companies, pertinent data relating to fourth quarter results had been estimated in prior years. No estimate has been provided for 1975 and the consolidated statement of earnings reflects the actual results for the first three quarters. This change was considered necessary from the standpoint of eliminating the potential distortion that exists in estimates of this nature and the results of four actual quarters will be reflected in 1976 and thereafter. The effect on 1975 operations of omitting a fourth quarter estimate is approximated below by using actual fourth quarter results, now available:

Decrease in premiums earned	$ 743,077
Decrease in losses incurred	516,460
Decrease in loss adjustment expenses	78,020
Decrease in commissions	174,102

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Summary of Investments in Securities - Other than Securities of Affiliates

December 31, 1974

Type of Investment	Cost* and carrying value	Market value**	Admitted asset value
Bonds:			
States, municipalities and political subdivisions	$ 1,531,752	1,514,264	1,531,752
Industrial and miscellaneous	256,698	230,744	256,698
Total bonds	1,788,450	1,745,008	1,788,450
Common stocks:			
Public utilities	290,131	272,253	272,253
Banks, trusts and insurance companies	126,067	136,025	136,025
Industrial and miscellaneous	1,105,557	441,422	441,422
Total common stocks	1,521,755	849,700	849,700
Allowance for anticipated losses	300,000	-	-
Net common stocks	1,221,755	849,700	849,700
U. S. Treasury Bills	1,806,004	1,806,004	1,806,004
Total investments in securities - other than securities of affiliates	$ 4,816,209	4,400,712	4,444,154

*Cost represents original cost of stocks, and, as to debt obligations, original cost adjusted for amortization of premiums or accretion of discount.

**"Market value" is the valuation published in the NAIC Book of Valuation of Securities; in accordance with said book the major portion of the bonds are reflected at amortized cost.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Summary of Investments in Securities - Other than Securities of Affiliates

December 31, 1975

Type of Investment	Cost*	Market value**	Carrying value
Bonds:			
States, municipalities and political subdivisions	$ 1,633,280	1,633,280	1,633,280
Industrial and miscellaneous	566,597	566,544	566,597
Total bonds	2,199,877	2,199,824	2,199,877
Common stocks:			
Public utilities	275,447	279,315	279,315
Banks, trusts and insurance companies	126,067	128,575	128,575
Industrial and miscellaneous	161,622	125,943	125,943
Total common stocks	563,136	533,833	533,833
U. S. Treasury Bills	2,421,690	2,421,690	2,421,690
Total investments in securities - other than securities of affiliates	$ 5,184,703	5,155,347	5,155,400

*Cost represents original cost of stocks, and, as to debt obligations, original cost adjusted for amortization of premiums or accretion of discount.

**"Market value" is the valuation published in the NAIC Book of Valuation of Securities; in accordance with said book the major portion of the bonds are reflected at amortized cost.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Investment in Securities of Affiliates

Schedule II

Name of issuer and description of investment	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount	Equity taken up to earnings	Dividends	Amortization of excess cost	Net unrealized loss on marketable equity securities	Balance at close of period: Number of shares	Balance at close of period: Amount
1974								
Berkshire Hathaway Inc. common stock, $5 par value	48,715	$ 4,178,367	350,263	-	3,165	-	48,715	$ 4,525,465
Blue Chip Stamps common stock, $1 par value	250,000	3,670,302	417,500	60,000	155,833	-	250,000	3,871,969
1975								
Berkshire Hathaway Inc. common stock, $5 par value	48,715	$ 4,525,465	233,341	-	3,193	-	48,715	$ 4,755,613
Blue Chip Stamps common stock, $1 par value	250,000	3,871,969	437,500	60,000	155,833	241,000	250,000	3,852,636

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Premiums, Losses and Claims

Schedule VII

	Part 1 - Premiums				Part 2 - Losses and claims	
Line of business	Unearned premiums beginning of period	Net premiums written	Unearned premiums end of period	Premiums earned during period	Losses and claims incurred during period	Loss expense incurred during period
1974						
Fire	$ 279,125	316,176	259,967	335,334	(62,474)	
Workmen's compensation	6,117	706,481	26,681	685,917	646,941	
Liability other than auto	166,296	275,011	225,844	215,463	183,514	
Auto liability	143,742	321,817	34,725	430,834	326,376	
All other	66,196	263,255	132,966	196,485	285,274	
Reinsurance	241,417	1,292,672	544,652	989,437	759,694	
	$ 902,893	3,175,412	1,224,835	2,853,470	2,139,325	315,222
1975						
Fire	259,967	237,416	224,465	272,918	315,584	
Workmen's compensation	26,681	735,653	2,646	759,688	700,708	
Reinsurance	544,652	1,596,515	727,204	1,413,962	1,045,454	
All other	393,535	143,662	162,434	439,753	263,681	
	$ 1,224,835	2,713,246	1,116,749	2,886,321	2,325,427	340,086

BERKSHIRE HATHAWAY INC.

1975

ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.

1975 Annual Report to the Stockholders

BUSINESS OF THE COMPANY

The Company is engaged directly and through subsidiaries in the manufacture and sale of woven textiles in the United States and through a subsidiary in the sale of textile products in Canada. Through subsidiaries collectively referred to in this annual report as the Insurance Group, the Company is engaged in the underwriting of fire and casualty insurance throughout the United States. The Company owns approximately 98% of The Illinois National Bank & Trust Co. of Rockford, Illinois which is engaged in the commercial banking business. The Company and subsidiary members of the Insurance Group have significant holdings in Blue Chip Stamps, a California corporation — the businesses of which are more fully described herein.

CONTENTS

Berkshire Hathaway Inc.

To the Stockholders of Berkshire Hathaway Inc.:

Last year, when discussing the prospects for 1975, we stated "the outlook for 1975 is not encouraging". This forecast proved to be distressingly accurate. Our operating earnings for 1975 were $6,713,592, or $6.85 per share, producing a return on beginning shareholder's equity of 7.6%. This is the lowest return on equity experienced since 1967. Furthermore, as explained later in this letter, a large segment of these earnings resulted from Federal income tax refunds which will not be available to assist performance in 1976.

On balance, however, current trends indicate a somewhat brighter 1976. Operations and prospects will be discussed in greater detail below, under specific industry titles. Our expectation is that significantly better results in textiles, earnings added from recent acquisitions, an increase in equity in earnings of Blue Chip Stamps resulting from an enlarged ownership interest, and at least a modest improvement in insurance underwriting results will more than offset other possible negatives to produce greater earnings in 1976. The major variable — and by far the most difficult to predict with any feeling of confidence — is the insurance underwriting result. Present *very tentative* indications are that underwriting improvement is in prospect. If such improvement is moderate, our overall gain in earnings in 1976 likewise will prove moderate. More significant underwriting improvement could give us a major gain in earnings.

Textile Operations

During the first half of 1975 sales of textile products were extremely depressed, resulting in major production curtailments. Operations ran at a significant loss, with employment down as much as 53% from a year earlier.

In contrast with previous cyclical slumps, however, most textile producers quickly reduced production to match incoming orders, thus preventing massive industry-wide accumulation of inventories. Such cutbacks caused quite prompt reflection at the mill operating level when demand revived at retail. As a result, beginning about midyear business rebounded at a fairly rapid rate. This "V" shaped textile depression, while one of the sharpest on record, also became one of the shortest ones in our experience. The fourth quarter produced an excellent profit for our textile division, bringing results for the year into the black.

On April 28, 1975 we acquired Waumbec Mills Incorporated and Waumbec Dyeing and Finishing Co., Inc. located in Manchester, New Hampshire. These companies have long sold woven goods into the drapery and apparel trade. Such drapery materials complement and extend the line already marketed through the Home Fabrics Division of Berkshire Hathaway. In the period prior to our acquisition, the company had run at a very substantial loss, with only about 55% of looms in operation and the finishing plant operating at about 50% of capacity. Losses continued on a reduced basis for a few months after acquisition. Outstanding efforts by our manufacturing, administrative and sales people now have produced major improvements which, coupled with the general revival in textiles, have moved Waumbec into a significant profit position.

We expect a good level of profits from textiles in 1976. Continued progress is being made in the movement of Waumbec goods into areas of traditional marketing strength of Berkshire Hathaway, productivity should improve in both the weaving and finishing areas at Manchester, and textile demand continues firm at decent prices.

We have great confidence in the ability of Ken Chace and his team to maximize our strengths in textiles. Therefore, we continue to look for ways to increase further our scale of operation while avoiding major capital investment in new fixed assets which we consider unwise, considering the relatively low returns historically earned on large scale investment in new textile equipment.

Insurance Underwriting

The property and casualty insurance industry had its worst year in history during 1975. We did our share — unfortunately, even somewhat more. Really disastrous results were concentrated in auto and long-tail (contracts where settlement of loss usually occurs long after the loss event) lines.

Economic inflation, with the increase in cost of repairing humans and property far outstripping the general rate of inflation, produced ultimate loss costs which soared beyond premium levels established in a different cost environment. "Social" inflation caused the liability concept to be expanded continuously, far beyond limits contemplated when rates were established — in effect, adding coverage beyond what was paid for. Such social inflation increased significantly both the propensity to sue and the possibility of collecting mammoth jury awards for events not previously considered statistically significant in the establishment of rates. Furthermore, losses to policyholders which otherwise would result from mushrooming insolvencies of companies inadequately reacting to these problems are divided through Guaranty Funds among remaining solvent insurers. These trends will continue, and should moderate any optimism which otherwise might be justified by the sharply increased rates now taking effect.

Berkshire Hathaway's insurance subsidiaries have a disproportionate concentration of business in precisely the lines which produced the worst underwriting results in 1975. Such lines produce unusually high investment income and, therefore, have been particularly attractive to us under previous underwriting conditions. However, our "mix" has been very disadvantageous during the past two years and it well may be that we will remain positioned in the more difficult part of the insurance spectrum during the inflationary years ahead.

The only segment to show improved results for us during 1975 was the "home state" operation, which has made continuous progress under the leadership of John Ringwalt. Although still operating at a significant underwriting loss, the combined ratio improved from 1974. Adjusted for excess costs attributable to operations still in the start-up phase, underwriting results are satisfactory. Texas United Insurance Company, a major problem a few years ago, has made outstanding progress since George Billings has assumed command. With an almost totally new agency force, Texas United was the winner of the "Chairman's Cup" for achievement of the lowest loss ratio among the home state companies. Cornhusker Casualty Company, oldest and largest of the home state companies, continues its outstanding operation with major gains in premium volume and a combined ratio slightly under 100. Substantial premium growth is expected at the home state operation during 1976; the measurement of success, however, will continue to be the achievement of a low combined ratio.

Our traditional business at National Indemnity Company, representing well over half of our insurance volume, had an extraordinarily bad underwriting year in 1975. Although rates were increased frequently and significantly, they continually lagged loss experience throughout the year. Several special programs instituted in the early 1970s have caused significant losses, as well as a heavy drain on managerial time and energies. Present indications are that premium volume will show a major increase in 1976, and we hope that underwriting results will improve.

Reinsurance suffered the same problems as our direct business during 1975. The same remedial efforts were attempted. Because reinsurance contract settlements lag those of direct business, it well may be that any upturn in results from our direct insurance business will precede those of the reinsurance segment.

At our Home and Automobile Insurance Company subsidiary, now writing auto business only in the Cook County area of Illinois, experience continued very bad in 1975 resulting in a management change in October. John Seward was made President at that time, and has energetically and imaginatively implemented a completely revamped underwriting approach.

Overall, our insurance operation will produce a substantial gain in premium volume during 1976. Much of this will reflect increased rates rather than more policies. Under normal circumstances such a gain in volume would be welcome, but our emotions are mixed at present. Underwriting experience *should* improve — and we expect it to — but our confidence level is not high. While our efforts will be devoted to obtaining a combined ratio below 100, it is unlikely to be attained during 1976.

Insurance Investments

Gains in investment income were moderate during 1975 because premium volume remained flat and underwriting losses reduced funds available for investment. Invested assets, measured at cost at yearend, were close to identical with the level at the beginning of the year.

At the end of 1974 the net unrealized loss in the stock section of our portfolio amounted to about $17 million, but we expressed the opinion, nevertheless, that this portfolio overall represented good value at its carrying value of cost. During 1975 a net capital loss of $2,888,000 before tax credits was realized, but our present expectation is that 1976 will be a year of realized capital gain. On March 31, 1976 our net unrealized gains applicable to equities amounted to about $15 million. Our equity investments are heavily concentrated in a few companies which are selected based on favorable economic characteristics, competent and honest management, and a purchase price attractive when measured against the yardstick of value to a private owner.

When such criteria are maintained, our intention is to hold for a long time; indeed, our largest equity investment is 467,150 shares of Washington Post "B" stock with a cost of $10.6 million, which we expect to hold permanently.

With this approach, stock market fluctuations are of little importance to us — except as they may provide buying opportunities — but business performance is of major importance. On this score we have been delighted with the progress made by practically all of the companies in which we now have significant investments.

We have continued to maintain a strong liquid position in our insurance companies. In last year's annual report we explained how variations of 1/10 of 1% in interest rates result in million dollar swings in market value of our bonds. We consider such market fluctuation of minor importance as our liquidity and general financial strength make it highly improbable that bonds will have to be sold at times other than those of our choice.

Banking

It is difficult to find adjectives to describe the performance of Eugene Abegg, Chief Executive of Illinois National Bank and Trust of Rockford, Illinois, our banking subsidiary.

In a year when many banking operations experienced major troubles, Illinois National continued its outstanding record. Against average loans of about $65 million, net loan losses were $24,000, or .04%. Unusually high liquidity is maintained with obligations of the U. S. Government and its agencies, all due within one year, at yearend amounting to about 75% of demand deposits. Maximum rates of interest are paid on all consumer savings instruments which make up more than half of the deposit base. Yet, despite the maintenance of premier liquidity and the avoidance of "stretching" for high yield loans, the Illinois National continues as about the most profitable bank of its size, or larger, in the country.

In 1975 the thirty largest banks in the United States earned an average of .5% on total ssets. The Illinois National earned about four times that much. These same thirty largest banks carried down 7% of operating revenues to net income. Without counting any tax benefits from consolidation, Illinois National carried down 27%.

Gene Abegg opened the doors of the Illinois National Bank in 1931 with paid-in capital of $250,000. In 1932, its first full year of operation, it earned $8,782. No additional capital has been paid in, and we recommend reading its financial statements on pages 28-34 to see what a truly outstanding manager has built in 44 years at the helm.

Under the present interest rate structure, it is expected that earnings of the Bank will be off somewhat during 1976 but still will remain at a highly satisfactory level.

Blue Chip Stamps

During 1975 our holdings of Blue Chip Stamps remained at 25½% of that company's outstanding shares. However, early in 1976 our holdings were increased to 31½%. We expect some increase in our equity in Blue Chip's earnings in 1976 because of this increased ownership.

The stamp business continues its precipitous decline with volume in the year ended February 28, 1976 amounting to only one-sixth that of the peak year ended February 28, 1970. Don Koeppel and Bill Ramsey have done an extraordinary job of cost-cutting, which has served to moderate operating problems resulting from this evaporation of business. In addition, the acquisition of See's Candies in 1972 has proven a real winner. Chuck Huggins's management has been outstanding, and profits have moved up dramatically during the past several years.

Shareholders of Berkshire Hathaway Inc. desiring the current annual report of Blue Chip Stamps should write Mr. Robert H. Bird, Secretary, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Federal Income Tax Implications

In reading our earnings statement you will notice a significant amount of Federal income taxes paid in earlier years are now recoverable because of the net operating loss as computed for tax purposes, sustained in 1975. Such loss results from the exclusion from income of 100% of interest from state and local issues, and 85% of dividends from domestic corporations. We have exhausted our reservoir of available tax recoveries and, therefore, a repeat of our overall operating performance in 1976 would produce much smaller net earnings. While we do not expect this result, it is important that you are aware of the absence of this cushion in the event that operating losses, as calculated for Federal tax purposes, should continue.

Acquisition of K & W Products

In addition to the 1975 Waumbec acquisition, we acquired for cash and notes on January 6, 1976, 100% of the assets of K & W Products, including its insurance subsidiaries. The insurance operations are minor in scope, representing business already associated with National Indemnity Company. K & W Products manufactures specialty automotive chemicals for use in automobile maintenance, such as radiator and block sealants, gasket compounds and fuel and oil additives. The company has extensive trademark or trade name protection for its products, which it manufactures at plants in California and Indiana. Although relatively small, with sales of a little over

$2 million, it consistently has generated favorable earnings. Positioned as we now are with respect to income taxes, the addition of a solid source of taxable income is particularly welcome.

General Review

Your present management assumed responsibility at Berkshire Hathaway in May, 1965. At the end of the prior fiscal year (September, 1964) the net worth of the Company was $22.1 million, and 1,137,778 common shares were outstanding, with a resulting book value of $19.46 per share. Ten years earlier, Berkshire Hathaway's net worth had been $53.4 million. Dividends and stock repurchases accounted for over $21 million of the decline in company net worth, but aggregate net losses of $9.8 million had been incurred on sales of $595 million during the decade.

In 1965, two New England textile mills were the company's only sources of earning power and, before Ken Chace assumed responsibility for the operation, textile earnings had been erratic and, cumulatively, something less than zero subsequent to the merger of Berkshire Fine Spinning and Hathaway Manufacturing. Since 1964, net worth has been built to $92.9 million, or $94.92 per share. We have acquired total, or virtually total ownership of six businesses through negotiated purchases for cash (or cash and notes) from private owners, started four others, purchased a 31½% interest in a large affiliated enterprise and reduced the number of outstanding shares of Berkshire Hathaway to 979,569. Overall, equity per share has compounded at an annual rate of slightly over 15%.

While 1975 was a major disappointment, efforts will continue to develop growing and diversified sources of earnings. Our objective is a conservatively financed and highly liquid business — possessing extra margins of balance sheet strength consistent with the fiduciary obligations inherent in the banking and insurance industries — which will produce a long term rate of return on equity capital exceeding that of American industry as a whole.

Warren E. Buffett, Chairman

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
KIEWIT PLAZA
OMAHA, NEBRASKA 68131

The Board of Directors and Stockholders
Berkshire Hathaway Inc.:

We have examined the consolidated balance sheets of Berkshire Hathaway Inc. and consolidated subsidiaries as of January 3, 1976 and December 28, 1974, the balance sheets of the Berkshire Hathaway Inc. - Insurance Group as of December 31, 1975 and 1974, and the related consolidated statements of earnings and retained earnings and changes in financial position of Berkshire Hathaway Inc. for the 53 weeks ended January 3, 1976 and the 52 weeks ended December 28, 1974 and the statements of income and unassigned surplus and changes in financial position of the Berkshire Hathaway Inc. - Insurance Group for the years ended December 31, 1975 and 1974. Except as stated in the following paragraph, our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Blue Chip Stamps, an investee of Berkshire Hathaway Inc., as described in note 5 to consolidated financial statements, was examined by other auditors for its most recent fiscal year ended March 1, 1975. Unaudited earnings of Blue Chip Stamps for the nine months ended November 29, 1975 was the basis in part for the amount of equity in earnings of Blue Chip Stamps recorded by Berkshire Hathaway Inc. Under the terms of our engagement, we did not examine evidence in support of the unaudited earnings and accordingly do not express an opinion as to the equity of $2,002,652 in earnings of Blue Chip Stamps for 1975.

In our opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had the earnings of Blue Chip Stamps been audited for the nine months ended November 29, 1975, the aforementioned consolidated financial statements present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries at January 3, 1976 and December 28, 1974 and the Berkshire Hathaway Inc. - Insurance Group at December 31, 1975 and 1974 and the results of their operations and the changes in their financial position for the respective years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

March 26, 1976

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	Jan. 3, 1976	Dec. 28, 1974
Cash	$ 6,044,526	$ 4,230,559
Investments, other than affiliates (notes 3 and 4):		
U. S. Treasury Bills and other short-term obligations, at cost which approximates market	16,175,265	11,108,163
Bonds, at amortized cost	78,760,945	71,530,651
Preferred stocks, at cost	2,558,275	2,855,185
Common stocks of unaffiliated companies, at cost	39,341,135	50,669,865
Total investments, other than affiliates	136,835,620	136,163,864
Investments in affiliates (notes 5 and 6):		
Common stock of Blue Chip Stamps	18,777,479	16,923,998
Unconsolidated bank subsidiary	23,424,329	22,416,879
Other unconsolidated subsidiaries	1,120,333	1,187,333
Total investments in affiliates	43,322,141	40,528,210
Recoverable Federal income taxes	4,400,000	2,800,734
Accounts receivable from customers, agents and others, net (note 7)	19,710,105	17,891,227
Inventories (note 8)	8,135,615	5,999,552
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (note 9)	3,722,242	3,913,473
Deferred insurance premium acquisition costs	2,950,000	4,400,000
Other assets	621,168	285,954
	$225,741,417	$216,213,573

LIABILITIES AND STOCKHOLDERS' EQUITY

Losses and loss adjustment expenses	$ 73,033,492	$ 72,761,097
Unearned premiums	22,344,290	21,704,867
Funds held under reinsurance treaties	2,939,462	2,857,284
Amounts due for purchase of securities	679,990	294,101
Accounts payable and accrued expenses	5,790,070	4,435,325
Income taxes:		
Current	178,546	163,809
Deferred	2,518,786	3,043,800
7½% debentures due 1987 (note 10)	505,820	555,780
Sundry installment promissory notes (note 11)	3,602,480	1,274,437
8% senior notes due 1993 (note 12)	20,000,000	20,000,000
Excess of net assets of consolidated subsidiaries over cost of investment	579,070	579,070
Other liabilities	679,219	345,376
	132,851,225	128,014,946
Stockholders' equity:		
Common stock of $5 par value. Authorized 1,100,000 shares; issued and outstanding 979,569 shares	4,897,845	4,897,845
Retained earnings (note 12)	87,992,347	83,300,782
Total stockholders' equity	92,890,192	88,198,627
Commitment and contingent liability (notes 14 and 17)		
	$225,741,417	$216,213,573

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

	Fiscal Year 1975	Fiscal Year 1974
Income items:		
Insurance premiums earned	$ 58,335,706	$ 60,573,729
Net sales of textile products	32,833,372	32,591,874
Interest and dividend income	8,918,240	8,029,876
Real estate income	287,314	286,307
	100,374,632	101,481,786
Cost and expense items:		
Insurance losses and loss adjustment expenses	47,237,737	47,119,846
Cost of textile products sold	28,234,179	27,429,277
Insurance underwriting expenses	21,744,891	20,345,744
Selling, administrative and other expenses	4,192,399	3,640,720
Interest expense	1,845,396	1,717,944
	103,254,602	100,253,531
Earnings (loss) from insurance underwriting and manufacturing operations before applicable income taxes	(2,879,970)	1,228,255
Income tax credit applicable to operating earnings (loss) (note 13)	4,140,910	2,010,321
Earnings before equity in net earnings of other companies and realized investment losses	1,260,940	3,238,576
Equity in net earnings of bank subsidiary	3,450,000	4,093,000
Equity in net earnings of Blue Chip Stamps	2,002,652	1,052,000
Earnings before realized investment losses	6,713,592	8,383,576
Realized investment losses	(2,888,062)	(1,908,093)
Applicable income tax credit	866,035	567,678
Net realized investment (losses)	(2,022,027)	(1,340,415)
Net unrealized appreciation (depreciation) in market values of preferred and common stocks of unaffiliated companies of $17,148,000 in 1975 and ($4,356,000) in 1974 have not been included in the determination of net earnings.		
Net earnings	4,691,565	7,043,161
Retained earnings at beginning of year	83,300,782	76,257,621
Retained earnings at end of year	$ 87,992,347	$ 83,300,782
Earnings per share of common stock, based on 979,569 shares outstanding:		
Earnings before realized investment (losses)	$ 6.85	$ 8.56
Realized investment (losses)	(2.06)	(1.37)
Net earnings	$ 4.79	$ 7.19

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Fiscal Year 1975	1974
Funds provided:		
From operations:		
Net earnings	$ 4,691,565	$ 7,043,161
Charges (credits) to earnings not requiring (providing) funds:		
Equity in undistributed earnings of bank subsidiary	(1,007,450)	(1,406,345)
Equity in undistributed earnings of Blue Chip Stamps	(1,853,481)	(889,410)
Accretion of discount on bonds	(384,278)	(442,153)
Depreciation and amortization	536,632	538,063
Decrease in deferred insurance premium acquisition costs	1,450,000	840,000
Increase in recoverable income taxes	(1,599,266)	(2,800,734)
Increase in accounts receivable from customers, agents and others	(32,731)	(3,834,653)
Decrease in inventories	507,771	1,137,124
Increase in unpaid losses and loss adjustment expenses	272,395	11,085,329
Increase in unearned premiums	639,423	422,887
Increase in funds held under reinsurance treaties	82,178	1,539,079
Increase (decrease) in accounts payable and accrued expenses	378,721	(291,284)
Decrease in liability for income taxes	(510,277)	(352,116)
Other, net	45,309	(329,243)
	(1,475,054)	5,216,544
Funds provided from operations	3,216,511	12,259,705
Dividends received from unconsolidated subsidiary	82,000	191,500
Proceeds from issuance of long-term debt	1,150,000	1,305,623
	$ 4,448,511	$13,756,828
Funds used:		
Subsidiaries acquired (note 2):		
Cash	210,577	—
Accounts receivable	1,786,147	—
Inventories	2,643,834	—
Other assets	46,680	—
Accounts payable and accrued expenses	(1,361,913)	—
Notes payable	(1,665,000)	—
	1,660,325	—
Additions to equipment, furniture and lease-hold improvements	345,401	783,531
Repayment of debt	536,917	73,946
Cost of net purchase (sale) of investments:		
U. S. Treasury Bills	5,067,102	9,707,728
Bonds	6,846,016	(1,985,528)
Preferred stocks	(296,910)	556,837
Common stocks of unaffiliated companies	(11,328,730)	913,087
Common stock of Blue Chip Stamps	—	2,317,313
Investment in unconsolidated subsidiary	15,000	45,000
	302,478	11,554,437
Increase in cash	1,603,390	1,344,914
	$ 4,448,511	$13,756,828

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 3, 1976 and December 28, 1974

(1) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

The accounts of Berkshire Hathaway Inc., the parent Company, are consolidated with the accounts of wholly-owned subsidiaries engaged in the textile business, and the accounts of subsidiary insurance companies (The "Insurance Group"), wholly-owned by Berkshire Hathaway Inc.

The parent Company's investment in The Illinois National Bank & Trust Co. of Rockford is accounted for on the equity basis.

Immaterial subsidiaries are not consolidated and investments therein are carried at cost less dividends received from such subsidiaries.

The accounts of the parent Company and its consolidated noninsurance subsidiaries are maintained on the basis of a fiscal year ending on the Saturday nearest to December 31, while the accounts of the Insurance Group are maintained on the basis of the calendar year. Fiscal year 1975 comprised 53 weeks operations of the textile business.

(b) Investment in Securities, Other than Affiliates

Investments in bonds are stated at amortized cost; investments in preferred and common stocks other than affiliates are carried at the lower of cost or market value at December 31, 1975 and at cost at December 31, 1974. The investments in equity securities are held by the Insurance Group and are stated at cost. These investments generally consist of a relatively few issues acquired with a general view to holding as long-term investments. In view of the fact that market value quotations fluctuate daily, management considers the cost method as most appropriate for such long-term investments, and has consistently applied such method.

However, pursuant to the dictates of Statement of Financial Accounting Standards No. 12, the Company has changed its method of accounting for these investments whereby they are reflected at the lower of cost or market value at December 31, 1975. There was no effect of this change at December 31, 1975 since market value exceeded cost on an aggregate basis. Any future adjustment of the carrying value will be reflected through a direct charge or credit to stockholders' equity.

(c) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps ("Blue Chip") is accounted for on the equity basis. Deferred income taxes are provided for with respect to undistributed earnings of Blue Chip under the assumption that such earnings will ultimately be distributed as taxable dividends. Blue Chip determines income on the basis of a fiscal year ending on or about February 28. Berkshire Hathaway Inc. reflects its equity in the earnings of Blue Chip on the basis of that company's twelve months ending on or about November 30.

(d) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the term of the policies. Unearned premiums are computed on the monthly pro rata basis and are stated after deduction for reinsurance placed with reinsurers in the amount of $2,885,610 at December 31, 1975 and $4,583,628 at December 31, 1974. Premium acquisition costs such as commissions, premium taxes and certain other underwriting expenses are, pursuant to statutory insurance accounting rules, charged against income when incurred. However, for financial statement purposes, a portion of such costs are deferred and charged against income as the related premiums are earned.

(e) Losses and Loss Adjustment Expenses

The Insurance Group provides for losses and loss adjustment expenses based upon (1) aggregate case basis estimates for losses reported, in respect to direct premiums written, (2) estimates of unreported losses based upon past experience, (3) estimates received relating to assumed reinsurance, and (4) deduction of amounts for reinsurance placed with reinsurers in the amount of $6,094,384 at December 31, 1975 and $5,518,385 at December 31, 1974.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(f) *Real Estate, Equipment, Furniture and Leasehold Improvements*

These items of property (including significant betterments and renewals) are carried at cost depreciated over their useful lives estimated at the date of acquisition. The double-declining balance method is used to calculate depreciation of new items of textile properties acquired after 1965; the straight-line method is applied for other items. Maintenance, repairs and renewals of a minor nature are generally charged to operations as incurred.

(g) *Inventories*

Inventories relate to the textile operations and are stated at cost, determined for the parent Company under the last-in, first-out method at both December 31, 1975 and December 31, 1974; cost of inventories of textile subsidiaries are determined under the first-in, first-out method.

(h) *Income Taxes*

A consolidated Federal income tax return is filed by the parent Company and its eligible subsidiaries. The recoverable amount reflected in the consolidated balance sheets includes the apportioned Federal tax amounts of the companies whose accounts are consolidated.

A provision for deferred taxes is made in recognition of timing differences created by the manner in which the Insurance Group accounts for certain income and expense items for financial reporting purposes and the accounting treatment of these items for income tax purposes.

Investment tax credits on qualifying property and equipment acquisitions are applied as a reduction of income tax expense in the year realized.

(2) Acquisition of Waumbec Mills Incorporated

On April 28, 1975, the parent Company purchased all of the outstanding capital stock of Waumbec Mills Incorporated ("Waumbec"), Manchester, New Hampshire. Waumbec is engaged in manufacturing, distributing and selling woven fabrics. A wholly-owned subsidiary of Waumbec engages at the same location in the finishing of textile fabrics. The acquisition of Waumbec has been accounted for as a purchase, and results of operations from date of acquisition are included in the consolidated statements of earnings for 1975.

The cost of Waumbec to the Company, including direct acquisition costs, was $1,660,325; installment promissory notes of principal amount of $1,150,000, which bear interest at 8% per annum, were issued by the parent Company in partial consideration of the purchase price with the balance paid in cash.

The net book value of assets less liabilities of Waumbec was in excess of the purchase price; such excess was applied in accordance with the Accounting Principles Board Opinion No. 16 to eliminate the net property, plant and equipment accounts of Waumbec and its subsidiary as they existed at the purchase date. As a result of that acquisition adjustment, no depreciation expense with respect to the acquired properties (which as to Waumbec's prior basis of accountability amounted to $239,000 during the period of Berkshire Hathaway's ownership in 1975), has been charged to earnings, nor will such depreciation be chargeable to future consolidated earnings.

Waumbec and its subsidiary as of the date of acquisition had unused net operating loss carryovers, as defined by the Internal Revenue Code, of approximately $2.6 million. To the extent that future tax benefits are derived from such carryovers, they will be accounted for as "negative goodwill" to be amortized into consolidated income in future periods which will not coincide with the periods in which benefits, if any, are realized. Such benefits will arise only if Waumbec and its subsidiary have future taxable income, and then only to the extent that such income exceeds aggregate net losses for tax purposes, if any, of other members of the consolidated group. Management of Berkshire Hathaway Inc. believes some tax benefits might be realized, though their effect on income in any given future accounting period would not be material in amount.

Had the purchase of Waumbec been consummated on the same basis as of the beginning of 1974, certain items in the consolidated statements of earnings on a pro forma basis would have been as follows:

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

	1975	1974
Net sales of textile products	$ 35,965,000	$ 45,900,000
Total income items	103,507,000	114,780,000
Earnings before equity in net earnings of other companies and realized investment losses	608,000	3,567,000
Net earnings	4,039,000	7,372,000
Net earnings per share	4.12	7.53

(3) **Bonds and Common Stocks Deposited with Others**

Common stocks with a cost of $2,619,268 (market value $2,437,500) at December 31, 1975 and bonds with amortized cost of $20,911,305 and $15,294,910 at December 31, 1975 and 1974, respectively, were deposited in trust with various regulatory authorities or others.

(4) **Investment in Securities of Unaffiliated Companies**

A summary of the aggregate cost and approximate market value of investments in securities of unaffiliated companies at December 31, 1975 and 1974 is as follows:

	1975		1974	
	Cost	*Market*	*Cost*	*Market*
Bonds	$78,760,945	$74,487,055	$71,530,651	$58,907,900
Equity securities:				
Preferred stocks	2,558,275	2,886,871	2,855,185	1,842,817
Common stocks	39,341,135	39,280,357	50,669,865	34,802,358
	$41,899,410	$42,167,228	$53,525,050	$36,645,175

At December 31, 1975, with respect to equity securities, gross unrealized gains were $3,795,267 and gross unrealized losses, $3,527,448. A net realized loss of $2,888,062 (before tax benefit) on the sale of securities was included in the determination of net income for 1975. The cost of securities sold is generally determined on a first-in, first-out basis.

(5) **Investment in Blue Chip Stamps**

The carrying value of the investment in Blue Chip Stamps ("Blue Chip") represents the cost, less amortization of the net excess of cost over equity in net assets at dates of acquisition, plus equity in undistributed earnings. Deferred taxes of $337,786 and $191,800 at December 31, 1975 and 1974, respectively, have been provided with respect to the equity in undistributed earnings assuming their ultimate distribution as a taxable dividend.

The investment in Blue Chip is summarized as follows:

	December 31,	
	1975	1974
Shares owned	1,325,233	1,325,233
Percentage of total outstanding shares	25.6%	25.6%
Cost, represented by:		
Underlying net asset values at dates of acquisition	$13,084,112	$13,084,112
Net excess cost, less amortization of $1,353,994, 1975 and $1,179,873, 1974	696,482	870,603
	13,780,594	13,954,715
Equity in post-acquisition undistributed earnings	4,996,885	2,969,283
	$18,777,479	$16,923,998

The excess of cost over equity in net assets is being amortized over eight years from the beginning of 1972. Amortization was $174,121 for 1975 and $384,200 for 1974.

As indicated above, Berkshire Hathaway Inc. and its subsidiaries own approximately 26% of Blue Chip; these holdings plus holdings of other persons who may be considered affiliates aggregate over 50% of Blue Chip's outstanding shares.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Blue Chip Stamps, a California corporation, and its subsidiaries are engaged in four lines of business: (1) Blue Chip provides a trading stamp service to retail merchants and their customers in California and Nevada. (2) A division, Blue Chip Incentives, on a nationwide basis, develops incentive programs for businesses and also develops, for oil companies and other large issuers of credit cards, complete merchandise packages for their credit card holders. (3) A subsidiary, See's Candy Shops, Incorporated, produces quality candy and confectionary products in fully equipped kitchens in Los Angeles and South San Francisco. The candy is sold fresh to the public in approximately 170 company-operated shops in ten western states including Hawaii. (4) A 64%-owned, unconsolidated subsidiary, Wesco Financial Corporation, owns all of the outstanding stock of Mutual Savings and Loan Association. Mutual's head office is in Pasadena, and its fifteen other locations are also in Southern California.

The financial statements of Blue Chip as of March 1, 1975, and for the 52 weeks then ended (audited), and as of November 29, 1975 and for the 52 weeks then ended (unaudited) reflect the following:

BLUE CHIP STAMPS
Consolidated Balance Sheets

	($000 omitted)	
Assets	*Mar. 1, 1975*	*Nov. 29, 1975 (Unaudited)*
Cash	$ 1,506	$ 2,607
Marketable securities, at cost (market March 1—$59,594; November 29—$62,600)	77,541	76,095
Inventories	11,767	13,824
Property, fixtures and equipment, net	8,273	8,339
Investment in Wesco Financial Corporation	26,307	27,911
Excess of cost over equity in net assets of consolidated subsidiary	15,883	15,595
Other assets	12,218	13,083
	$153,495	$157,454
Liabilities and Stockholders' Equity		
Liability for unredeemed trading stamps	$ 72,183	$ 70,962
6¾% subordinated debentures due 1978	6,512	6,392
Other liabilities	7,491	8,853
Stockholders' equity	67,309	71,247
	$153,495	$157,454

BLUE CHIP STAMPS
Consolidated Earnings Summaries

	($000 omitted)	
	52 weeks ended *Mar. 1, 1975*	52 weeks ended *Nov. 29, 1975 (Unaudited)*
Stamp service revenues	$ 25,564	$ 21,502
Merchandise promotions and incentive sales	11,022	12,804
Candy sales	42,907	47,582
Other revenues	9,872	6,657
Total revenues	$ 89,365	$ 88,545
Earnings before securities gains (losses) and extraordinary credit	$ 7,508	$ 7,568
Per share	1.45	1.46
Net earnings	8,665	9,183
Per share	1.67	1.77

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Had the provisions of statement of Financial Accounting Standards No. 12 been effective with respect to the preceding presentations, Blue Chip's marketable securities would have been carried in the November 29, 1975 balance sheet at market value which amount was, as indicated, $13,495,000 less than cost. Such amount would have been applied as a reduction of stockholders' equity of Blue Chip Stamps, and Berkshire Hathaway Inc. would have recorded its proportionate share of such reduction, or $3,455,000 as a reduction of its stockholders' equity at January 3, 1976. Of such amount, $2,580,000 would have applied as a reduction of capital and surplus of the Insurance Group as of December 31, 1975.

Blue Chip financial statements for their fiscal year ended March 1, 1975 (and for certain prior years) revealed significant litigation proceedings against the Company. The Company stated with regard to certain of these proceedings that a possible result could be to "compel it to discontinue issuance of trading stamps." Additional proceedings involve substantial contingent liabilities; the accountants' opinion covering the financial statements of Blue Chip Stamps as of March 1, 1975 and for the fiscal year then ended, as well as that for certain preceding years, was given subject to the effect, if any, of the legal proceedings referred to.

(6) Investments in Unconsolidated Subsidiaries

The investment in the unconsolidated bank subsidiary represents approximately 98% of the outstanding stock of The Illinois National Bank & Trust Co. of Rockford. The equity method is used in accounting for this investment. See note 14 regarding divestiture of this investment. Financial statements of The Illinois National Bank & Trust Co. of Rockford and subsidiary are presented elsewhere herein.

The carrying values of $24,544,662 at January 3, 1976 and $23,604,212 at December 28, 1974 for all unconsolidated subsidiaries were approximately $2,500,000 in excess of the parent Company's equity in the net assets as reflected in the financial statements of the subsidiaries at those dates. This excess cost originated prior to November 1, 1970 and is not being amortized since it is considered by management to have continuing value over an indefinite period.

(7) Receivables

Accounts receivable from customers, agents and others was made up of the following:

	December 31, 1975	December 31, 1974
Insurance Group:		
Agents' balances and premiums in course of collection	$ 6,949,958	$ 9,583,769
Investment income due and accrued	1,649,292	1,438,492
Reinsurance recoverable on loss payments	4,520,912	2,459,093
Amounts due from sale of securities	23,084	31,955
	13,143,246	13,513,309
Textile business trade accounts receivable (less allowance for doubtful accounts, 1975—$362,095; 1974—$331,394)	6,566,859	4,377,918
	$19,710,105	$17,891,227

(8) Inventories

A summary of inventories follows:

	Jan. 3, 1976	Dec. 28, 1974
Raw materials and supplies	$1,717,825	$ 832,210
Stock in process	2,987,238	1,425,670
Griege and finished cloth	3,430,552	3,741,672
	$8,135,615	$5,999,552

Cost of inventories of the parent Company are determined by the last-in, first-out ("LIFO") method. Cost of inventories of subsidiaries are determined by first-in, first-out ("FIFO") method. Cost using FIFO for all inventories would have exceeded balance sheet carrying amounts by $1,261,642 and $1,234,436 at January 3, 1976 and December 28, 1974, respectively.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(9) Real Estate, Equipment, Furniture and Leasehold Improvements

The composition of plant and equipment is shown below:

January 3, 1976	*Properties of textile operations*	*Properties of Insurance Group*	*Total*
Land	$ 84,860	$ 83,847	$ 168,707
Buildings	2,409,214	1,260,989	3,670,203
Machinery and equipment	13,035,988	—	13,035,988
Furniture and fixtures and leasehold improvements	772,810	1,141,562	1,914,372
	16,302,872	2,486,398	18,789,270
Less accumulated depreciation and amortization	14,106,876	960,152	15,067,028
	$ 2,195,996	$1,526,246	$ 3,722,242
December 28, 1974			
Land	$ 84,860	$ 83,847	$ 168,707
Buildings	2,409,214	1,254,363	3,663,577
Machinery and equipment	12,734,171	—	12,734,171
Furniture and fixtures and leasehold improvements	834,992	1,053,380	1,888,372
	16,063,237	2,391,590	18,454,827
Less accumulated depreciation and amortization	13,730,358	810,996	14,541,354
	$ 2,332,879	$1,580,594	$ 3,913,473

(10) 7½% Subordinated Debentures

Debentures bear interest at the rate of 7½% payable February 1 and August 1 and will be due on August 1, 1987. The debentures are not secured by any lien and are not convertible; they are subordinated to senior indebtedness which includes indebtedness of the parent Company for money borrowed. The debentures may be redeemed at par at the Company's option. The indenture under which the debentures were issued requires the parent Company to redeem $42,800 principal amount of the debentures, through a sinking fund, annually on August 1 through 1986.

(11) Sundry Installment Promissory Notes

This caption includes the following:

	December 31, 1975	December 31, 1974
Parent Company:		
8% note issued May 1974, repayable in monthly installments of $13,071 including interest, through February 1988	$1,217,480	$1,274,437
8% notes issued April 1975, repayable in annual installments of $287,500 plus interest, in each of the years 1977 through 1980	1,150,000	—
Obligations of subsidiary acquired in 1975:		
6% note issued 1973, repayable in semiannual installments of $80,000 plus interest through August 1, 1978	480,000	—
Note issued 1973, principal repayable in annual installments of $70,000 through May 1, 1983, plus interest at 5% through April 30, 1978 and 6% thereafter*	560,000	—
8% note issued in April 1975 with a fixed due date of April 30, 1980, contingently due earlier*	195,000	—
	$3,602,480	$1,274,437

*Guaranteed by parent Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(12) 8% Senior Notes due 1993

The parent Company in 1973 issued $20,000,000 8% Senior notes with final maturity March 1, 1993. The notes call for mandatory annual prepayments of $1,143,000 on March 1 in each of the years from 1979 to 1992, inclusive. Optional prepayments are permitted without premium up to the amount of the required prepayments in each of the years 1979 to 1992; this right is not cumulative. Additionally, the parent Company may also prepay the notes at any time, in full or in part, at a premium declining ratably from the current rate of approximately 7% to par in 1992. The parent Company agreed it will not affect any optional prepayment prior to March 1, 1983 from proceeds of any refunding operation involving the incurring of any indebtedness at an effective annual interest rate of less than 8%.

In the note instruments the parent Company agreed, among other things, as to both the parent Company and restricted subsidiaries, as defined, to limitations as to permissible outstanding funded debt and subordinated funded debt and to a limitation on mortgage debt except as to after-acquired property. Further, the parent Company covenanted that it would not make "restricted payments", which term includes dividends or other equity distributions plus investment in unrestricted subsidiaries (those not bound by the terms of the loan agreement), in excess of stated formula amounts. Retained earnings of approximately $26,000,000 as of January 3, 1976 are unrestricted by this provision; the remainder is restricted.

The loan agreement also contains limiting terms relating to sales of the Company's assets, mergers and consolidations, and allows the noteholders to demand prepayment, at par, within 60 days of notice that, during the lifetime of Warren E. Buffett, stock ownership in the parent Company by Warren E. Buffett and the members of his immediate family, including certain trusts and charitable organizations, has decreased to less than 15% of the outstanding capital stock of the parent Company.

(13) Income Taxes

Net recoverable income taxes credited to 1975 earnings represent a current expense credit of $4,313,045 and a deferred expense credit of $525,014, composed of the following:

	U.S. Federal	*Foreign, state and local*	*Total*
Totals:			
Credit (expense) applicable to operating loss	$4,528,690	$(131,521)	$4,397,169
(Charge) applicable to equity in earnings of Blue Chip Stamps	(168,886)	—	(168,886)
Credit applicable to realized investment losses	609,776	—	609,776
	$4,969,580	$(131,521)	$4,838,059
Current credit (expense) applicable to:			
Operating loss	$3,857,690	$(131,521)	$3,726,169
Dividends from Blue Chip Stamps	(22,900)	—	(22,900)
Realized investment losses	609,776	—	609,776
	4,444,566	(131,521)	4,313,045
Deferred credit (expense) applicable to:			
Change in deferred insurance premium acquisition costs	696,000	—	696,000
Accreted discount on tax free bonds	(281,259)	—	(281,259)
Undistributed income of Blue Chip Stamps	(145,986)	—	(145,986)
Cumulative accreted discount on tax free bonds sold	104,185	—	104,185
Benefit of capital loss carryover	152,074	—	152,074
	525,014	—	525,014
Total credit (expense)	$4,969,580	$(131,521)	$4,838,059

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

A before tax net loss of $146,494 was realized in 1975. A reconciliation of the tax credit from such net loss at the statutory rate to the above credit follows:

	Amount
Tax credit at 48% statutory rate	$ 70,000
Increases (decreases) resulting from:	
Tax-exempt interest income	2,137,000
85% dividends received credit:	
On dividends from unaffiliated companies	978,000
On equity in earnings of Blue Chip Stamps	957,000
100% exclusion relating to equity in earnings of The Illinois National Bank	1,656,000
Capital loss rate differential (30% vs. 48%)	(520,000)
Tax benefit to unconsolidated subsidiary	(319,000)
Other, net	(120,941)
Total tax credits	$4,838,059

As of December 31, 1975, taxes paid and recoverable in the event of future operating losses were minimal. Unused net operating loss carryovers in acquired subsidiaries exist in the amount of $2,600,000 expiring in 1977, 1978 and 1979. These can only be offset against taxable income earned by the acquired subsidiaries, and any tax benefits realized therefrom would be accounted for as a reduction of purchase price resulting in their amortization into income over a period not to exceed forty years.

Net recoverable income taxes credited to 1974 earnings were made up as follows:

	U.S. Federal	Foreign, state and local	Total
Totals:			
Credit (charge) applicable to operating earnings	$2,187,851	$(177,530)	$2,010,321
(Charge) applicable to equity in earnings of Blue Chip Stamps	(112,090)	–	(112,090)
Credit applicable to realized investment losses	567,678	–	567,678
	$2,643,439	$(177,530)	$2,465,909
Currently recoverable (payable):			
From net operating loss from insurance underwriting and manufacturing operations	$1,842,483	$(177,530)	$1,664,953
On dividends from Blue Chip Stamps	(20,290)	–	(20,290)
From carryback of realized investment losses	567,678	–	567,678
Total current	2,389,871	(177,530)	2,212,341
Deferred credit (expense):			
On equity in undistributed earnings of Blue Chip Stamps	(91,800)	–	(91,800)
On net accreted discount on bonds	(75,632)	–	(75,632)
Credit for tax effect of reduction in deferred insurance premium acquisition costs	421,000	–	421,000
Total deferred	253,568	–	253,568
Total income tax credits	$2,643,439	$(177,530)	$2,465,909

Total net income after taking into account realized investment losses, but before income taxes, was $4,577,252. Income tax expense of approximately $2,197,000 would result if computed by applying the statutory U.S. Federal income tax rate of 48% to income before taxes. A reconciliation of the difference is as follows:

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

	Amount
Tax expense at statutory rate	$(2,197,000)
Decreases (increases) resulting from:	
Tax-exempt interest income	2,082,000
100% exclusion relating to equity in earnings of The Illinois National Bank	1,965,000
85% dividends received credit:	
On dividends from unaffiliated companies	1,065,000
On equity in earnings of Blue Chip Stamps	632,000
Amortization of excess of cost over net assets of subsidiary and investee (not deductible for tax purposes)	(230,000)
Capital loss rate differential (30% vs. 48%)	(343,000)
Tax benefits to unconsolidated subsidiary	(620,000)
Miscellaneous	111,909
Total tax credits	$2,465,909

(14) "One-Bank Holding Company" Status

The Company is a bank holding company under Federal legislation enacted in 1970. It has filed with the Federal Reserve Board an irrevocable election to divest of its holdings in The Illinois National Bank & Trust Co. of Rockford prior to January 1, 1981. No determination has been made as to how it will effect such divestiture, and so long as the Company controls the bank it is subject to the restrictions imposed upon it by the Bank Holding Company Act.

(15) "Savings and Loan Holding Company" Status

The Company, as a result of its investment in Blue Chip Stamps which in turn holds controlling interest in a California savings and loan association, is a savings and loan holding company under the Savings and Loan Holding Company Amendments of 1967. As such, the Company is subject to the restrictions and regulatory requirements imposed upon it by the Savings and Loan Holding Company Act.

(16) Subsequent Event

In early January 1976, National Fire & Marine Insurance Company acquired for approximately $2 million all of the outstanding capital stock of Kerkling Reinsurance Corporation ("Kerkling"), a Nebraska company engaged since its inception in 1970 in the underwriting of reinsurance risks. Its business has been derived essentially through the reinsurance department of National Indemnity Company. Kerkling's annual premium volume has been less than $1 million annually; its total assets at December 31, 1975 approximated $4 million. The purchase price for this corporation was book value, adjusted to generally accepted accounting principles.

In a related transaction on the same date, Berkshire Hathaway Inc. acquired substantially all of the other net assets of Kerkling's parent company. These acquired assets consisted of all of the outstanding stock of Transportation Facilities, Inc., a corporation operating a small insurance brokerage business, plus the net assets comprising a business engaged in the manufacture and sale of branded chemical products used in the automotive after market. The latter were acquired through a newly formed subsidiary of Berkshire Hathaway Inc., K & W Products, Inc. The acquired manufacturing facilities are located in Los Angeles, California and Bloomington, Indiana; K & W products are sold nationwide. Sales volume of this business approximated $2.5 million in 1975. Purchase price for these assets approximated $2.25 million, of which approximately $1 million was funded by issuance by Berkshire Hathaway Inc. of 9% installment promissory notes. The notes issued have maturities extending to 1987.

(17) Litigation

The company, together with a number of subsidiaries, officers, directors and employees of the Company and certain subsidiaries, was named as a defendant in a lawsuit filed in mid 1975 alleging numerous causes of action and seeking damages of several million dollars. Since the filing of the complaint, interrogatories have been served upon the plaintiff but the plaintiff has refused to answer such interrogatories, has refused to testify in pretrial proceedings relating to performance of certain of its obligations, and has conducted no discovery in this matter. In the opinion of counsel for the Company, the Company will not be affected materially by the final outcome of the proceeding.

Berkshire Hathaway Inc.
INSURANCE GROUP

BALANCE SHEETS

	December 31, 1975	December 31, 1974
ASSETS		
Investments — other than investments in affiliates (notes 3 and 4):		
Bonds, at amortized cost	$ 78,760,945	$ 71,530,651
Preferred stocks — at cost	2,558,275	2,855,185
Common stocks — at cost	39,341,135	50,669,865
U. S. Treasury Bills — at cost which approximates market	13,912,843	9,138,663
Total investments — other than investments in affiliates	134,573,198	134,194,364
Cash	2,000,940	1,513,636
Investment in Blue Chip Stamps (note C)	15,400,558	14,370,980
Accrued investment income	1,649,292	1,438,492
Premiums receivable and agents' balances	6,949,956	9,583,769
Reinsurance recoverable on paid losses	4,520,912	2,459,093
Property and equipment, at cost less accumulated depreciation (note 9)	1,526,246	1,580,594
Deferred premium acquisition costs	2,950,000	4,400,000
Recoverable Federal income taxes	4,100,000	2,600,734
Other assets	387,403	196,560
	$174,058,505	$172,338,222
LIABILITIES, CAPITAL STOCK AND SURPLUS		
Losses and loss adjustment expenses	73,033,492	72,761,097
Unearned premiums	22,344,290	21,704,867
Funds held under reinsurance treaties	2,939,462	2,857,284
Deferred income taxes	2,472,002	3,034,000
Other liabilities	2,322,089	1,750,074
	103,111,335	102,107,322
Capital stock and surplus:		
Common stock of National Indemnity Company of $10 par value. Authorized 750,000 shares; issued 550,000 shares	5,500,000	5,500,000
Common stock of National Fire & Marine Insurance Company of $100 par value. Authorized 50,000 shares; issued 25,000 shares	2,500,000	2,500,000
Paid-in surplus	20,601,250	20,601,250
Unassigned surplus (note D)	42,345,920	41,629,650
Total capital stock and surplus	70,947,170	70,230,900
	$174,058,505	$172,338,222

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF INCOME AND UNASSIGNED SURPLUS

	Year Ended December 31, 1975	Year Ended December 31, 1974
Underwriting income:		
Premiums written	$58,975,130	$60,996,616
Increase in unearned premiums	(639,424)	(422,887)
Premiums earned	58,335,706	60,573,729
Losses and claims	39,285,324	38,615,906
Loss adjustment expenses	7,952,413	8,503,940
Underwriting expenses (note E)	21,744,891	20,345,744
	68,982,628	67,465,590
Underwriting loss	(10,646,922)	(6,891,861)
Investment income:		
Interest on bonds	6,036,808	5,103,543
Dividends on stock of unaffiliated companies	2,456,103	2,811,980
Real estate income	287,314	286,307
	8,780,225	8,201,830
Less investment expenses	338,918	322,010
Net investment income	8,441,307	7,879,820
Other expense	121,451	95,708
Income (loss) before income taxes and items below	(2,327,066)	892,251
Applicable income tax credit (note F)	3,924,410	2,184,761
Income before items below	1,597,344	3,077,012
Equity in earnings of Blue Chip Stamps	1,140,953	791,985
Income before realized losses on investments	2,738,297	3,868,997
Realized loss on investments	(2,888,062)	(1,908,093)
Applicable income tax credit (note F)	866,035	567,678
Net realized loss on investments (note G)	(2,022,027)	(1,340,415)
Net unrealized appreciation (depreciation) in market values of preferred and common stocks of unaffiliated companies of $17,148,000 in 1975 and ($4,356,000) in 1974 have not been included in the determination of net income.		
Net income	716,270	2,528,582
Unassigned surplus at beginning of year	41,629,650	39,101,068
Unassigned surplus at end of year	$42,345,920	$41,629,650

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31, 1975	1974
Funds provided:		
From operations:		
Net income	$ 716,270	$ 2,528,582
Charges (credits) to income not requiring (providing) funds:		
Equity in undistributed earnings of Blue Chip Stamps	(1,029,578)	(653,706)
Accretion of discount on bonds	(384,278)	(442,153)
Depreciation	152,155	147,972
Increase in unpaid losses and loss expense	272,395	11,085,329
Increase in unearned premiums	639,423	422,887
Increase in funds held under reinsurance treaties	82,178	1,539,079
Decrease (increase) in agents' balances and premiums in course of collection	2,633,813	(2,691,992)
Increase in reinsurance recoverable on loss payments	(2,061,819)	(1,960,169)
Decrease in deferred acquisition costs	1,450,000	840,000
Decrease in liability for income taxes	(561,998)	(705,670)
Increase in recoverable income taxes	(1,499,266)	(2,600,734)
Other, net	170,372	(115,130)
	(136,603)	4,865,713
Funds provided from operations	579,667	7,394,295
Net sale of investments	5,444	—
	$ 585,111	$ 7,394,295
Funds used:		
Purchase of furniture and equipment	97,807	123,394
Net purchase of investments	—	7,222,624
Increase in cash	487,304	48,277
	$ 585,111	$ 7,394,295
Net purchase (sale) of investments:		
U. S. Treasury Bills	4,774,180	7,738,228
Bonds	6,846,016	(1,985,528)
Preferred stocks	(296,910)	556,837
Common stocks of unaffiliated companies	(11,328,730)	913,087
Net cost of investments (sold) purchased	$ (5,444)	$ 7,222,624

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS
December 31, 1975 and 1974

(A) Note References

Numerical note references are to the notes to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries. Note 1 to such statements includes a summary of significant accounting policies and practices of the Insurance Group.

(B) Basis of Presentation

The financial statements of Berkshire Hathaway Inc. – Insurance Group include the accounts of wholly-owned subsidiaries of Berkshire Hathaway Inc. which are engaged in fire and casualty insurance underwriting. The statements are presented on a combined basis with significant intercompany transactions and balances eliminated, and in accordance with generally accepted accounting principles (GAAP) which differ in some respects from principles prescribed or permitted by insurance regulatory authorities (statutory methods) in accordance with which the companies maintain their records. A reconciliation of the aggregate capital stock and surplus ("Surplus as regards Policyholders") as determined under the statutory method to that determined and reported herewith in accordance with GAAP is as follows:

	December 31, 1975	December 31, 1974
Statutory surplus as regards policyholders	$55,406,942	$37,201,793
Excess of NAIC market valuations over cost valuations of investments in equity securities (excluding stock of Blue Chip Stamps)	(267,819)	—
Excess of cost over NAIC market valuations of investments in equity securities (excluding stock of Blue Chip Stamps)	—	16,449,675
Excess of carrying value of investment in Blue Chip Stamps (determined under GAAP pursuant to the equity method) over NAIC market valuation	9,216,289	9,176,194
Deferred insurance premium acquisition costs	2,950,000	4,400,000
Excess statutory liability loss reserves	756,343	1,850,644
Net recoverable from unauthorized reinsurers	2,426,692	1,708,012
Sundry nonadmitted assets	2,930,725	1,042,892
Income tax effect and adjustments	(2,472,002)	(1,678,310)
Capital stock and surplus per accompanying financial statements	$70,947,170	$70,230,900

Statutory net income is reconciled to GAAP net income as follows:

	1975	1974
Statutory net income	$1,814,693	$2,354,072
Decrease in deferred acquisition costs	(1,450,000)	(840,000)
Equity in undistributed earnings of Blue Chip Stamps, net of amortization of excess cost	1,029,579	653,706
Amortization of excess cost of investment in Home and Automobile Insurance Company	—	(93,886)
Income tax effects and adjustments	(678,002)	454,690
Net income per accompanying financial statements	$ 716,270	$2,528,582

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

(C) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps by the companies comprising the Insurance Group represented 989,483 shares, or approximately 19% of that company's total outstanding shares at the end of both 1975 and 1974. The carrying value was comprised of the following:

	December 31, 1975	1974
Cost, represented by:		
Underlying net asset values at dates of acquisition	$ 9,115,779	$ 9,115,779
Excess cost, net of amortization of $1,764,181, 1975 and $1,279,853, 1974	1,937,314	2,421,642
	11,053,093	11,537,421
Equity in post-acquisition undistributed earnings	4,347,465	2,833,559
	$15,400,558	$14,370,980

The excess cost over underlying net assets is being amortized over eight years from the beginning of 1972. Amortization charges against earnings of the Insurance Group was $484,328 in 1975 and $484,180 in 1974.

See also note 5 to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries.

(D) Stockholders' Equity

Surplus is restricted for dividend purposes by the insurance departments of the states in which the companies do business.

(E) Underwriting Expenses

The following expenses made up underwriting expenses:

	1975	1974
Commissions and brokerage	$13,512,566	$13,016,977
Salaries and other compensation	3,027,683	2,816,024
Taxes, licenses and fees	1,508,145	1,396,162
Other underwriting expenses	2,246,497	2,276,581
Total statutory underwriting expenses	20,294,891	19,505,744
Add decrease in deferred acquisition costs	1,450,000	840,000
	$21,744,891	$20,345,744

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

(F) Federal Income Taxes

Federal income tax credits (expense) are made up of the following:

	1975	1974
Totals:		
Credit applicable to operating earnings	$3,924,410	$2,184,761
(Charge) applicable to equity in earnings of Blue Chip Stamps	(126,102)	(99,200)
Credit applicable to realized investment losses	866,035	567,678
Total credits	$4,664,343	$2,653,239
Current tax credits and (expense) relating to:		
Net operating loss for tax purposes of insurance underwriting operations	$3,509,669	$1,839,393
Dividends received from Blue Chip Stamps	(17,100)	(17,200)
Realized investment gains (losses)	609,776	567,678
Total current	4,102,345	2,389,871
Deferred tax credit and (expense) relating to:		
Equity in undistributed earnings of Blue Chip Stamps	(109,002)	(82,000)
Accreted discount on bonds	(177,074)	(75,632)
Credit for tax effect of reduction in deferred acquisition costs	696,000	421,000
Benefit of capital loss carryforward	152,074	—
Total deferred	561,998	263,368
Total credits	$4,664,343	$2,653,239

Total net loss after taking into account realized investment losses, but before income taxes, was $3,948,073 for 1975 and $124,657 for 1974. Income tax credits of approximately $1,895,000 for 1975 and $60,000 for 1974 would result if computed by applying the statutory U. S. Federal income tax rate of 48% to such losses before taxes. A reconciliation of the differences is as follows:

	1975	1974
Tax credits at statutory rate	$1,895,000	$ 60,000
Increase (reduction) in credits resulting from:		
Tax-exempt interest	2,137,000	2,082,000
85% dividends received credit relating to:		
Dividends received from unaffiliated companies	978,000	1,065,000
Equity in earnings of Blue Chip Stamps	715,000	561,000
Amortization of excess of cost over net assets of subsidiary and investee (not deductible for tax purposes)	(232,000)	(277,000)
Tax benefit to affiliate	(319,000)	(620,000)
Capital loss tax rate differential	(520,000)	(343,000)
Miscellaneous	10,343	125,239
Total credits	$4,664,343	$2,653,239

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

(G) Investment Gains and Losses

A summary of realized and unrealized investment gains (losses) for 1975 and 1974 is as follows:

	1975			
	Gross	*Applicable tax*	*Net*	*Unrealized*
Bonds	$ 239,041	$ (71,712)	$ 167,329	$ —
Preferred stocks	28,450	(8,535)	19,915	1,044,000
Common stocks	(3,155,553)	946,282	(2,209,271)	16,104,000
	$ (2,888,062)	$866,035	$ (2,022,027)	$17,148,000

	1974			
	Gross	*Applicable tax*	*Net*	*Unrealized*
Bonds	$ 91,817	$ (27,317)	$ 64,500	$ —
Preferred stocks	(138,579)	41,229	(97,350)	(901,000)
Common stocks	(1,861,331)	553,766	(1,307,565)	(3,455,000)
	$ (1,908,093)	$567,678	$ (1,340,415)	$ (4,356,000)

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
206 WEST STATE STREET, SUITE 700
ROCKFORD, ILLINOIS 61101

The Board of Directors
The Illinois National Bank &
Trust Co. of Rockford:

We have examined the consolidated balance sheets of the Illinois National Bank & Trust Co. of Rockford and subsidiary as of December 31, 1975 and 1974 and the related consolidated statements of earnings, changes in stockholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of the Illinois National Bank & Trust Co. of Rockford and subsidiary at December 31, 1975 and 1974 and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

January 14, 1976

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	December 31, 1975	December 31, 1974
ASSETS		
Cash and due from banks	$ 18,797,271	$ 21,543,577
Investment securities (note 2):		
United States Government obligations	24,180,903	565,107
United States Government agencies	15,576,778	10,050,113
Obligations of states and political subdivisions	46,769,523	45,857,638
Other securities	4,327,888	3,845,970
Federal funds sold	—	5,000,000
Loans (notes 3 and 6)	58,081,252	70,133,624
Bank premises and equipment (note 4)	966,626	1,008,749
Accrued interest receivable	2,040,487	1,812,021
Other assets	514,603	1,044,645
	$171,255,331	$160,861,444
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Demand deposits	$ 53,477,577	$ 53,177,813
Time deposits	93,501,325	85,519,225
Total deposits	146,978,902	138,697,038
Federal funds purchased	1,000,000	—
Accrued taxes and other liabilities (notes 5 and 6)	1,303,422	1,222,737
Total liabilities	149,282,324	139,919,775
Stockholders' equity:		
Common stock of $20 par value. Authorized and issued 250,000 shares	5,000,000	5,000,000
Surplus	5,000,000	5,000,000
Undivided profits (note 6)	10,972,007	9,940,669
Reserve for contingencies	1,001,000	1,001,000
Total stockholders' equity	21,973,007	20,941,669
	$171,255,331	$160,861,444

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF EARNINGS

	Years ended December 31, 1975	1974
Operating income:		
Interest and fees on loans	$ 5,711,826	$ 6,607,862
Income on Federal funds sold	213,649	361,452
Interest and dividends on:		
United States Government obligations	700,630	42,986
United States Government agencies	913,779	898,579
Obligations of states and political subdivisions	2,796,479	2,797,632
Other securities and time deposits	460,635	284,283
Total interest income	10,796,998	10,992,794
Trust fees	503,178	434,201
Service charges on deposit accounts	133,645	139,060
Other	583,229	559,578
Total operating income	12,017,050	12,125,633
Operating expenses:		
Interest on deposits	5,190,802	4,954,302
Interest on borrowed money	3,795	14,106
Total interest	5,194,597	4,968,408
Salaries	1,642,956	1,551,511
Employee benefits (note 7)	292,981	246,573
Occupancy, net (note 4)	246,770	257,229
Furniture and equipment (note 4)	246,233	248,078
Provision for loan losses (note 6)	11,900	19,300
Other	766,203	592,443
Total operating expenses	8,401,640	7,883,542
Earnings before income taxes and securities gains	3,615,410	4,242,091
Applicable income taxes, net (note 5)	136,502	220,256
Earnings before securities gains	3,478,908	4,021,835
Securities gains, net of related taxes of $2,185 in 1975 and $7,001 in 1974 (note 5)	52,430	168,022
Net earnings	$ 3,531,338	$ 4,189,857
Earnings per share:		
Earnings before securities gains	$13.92	$16.09
Securities gains	.21	.67
Net earnings	$14.13	$16.76

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common stock	*Surplus*	*Undivided profits (note 6)*	*Reserve for contingencies*
Balance, December 31, 1973	$5,000,000	$5,000,000	$ 8,500,812	$1,001,000
Net earnings	–	–	4,189,857	–
Cash dividends – $11 per share	–	–	(2,750,000)	–
Balance, December 31, 1974	5,000,000	5,000,000	9,940,669	1,001,000
Net earnings	–	–	3,531,338	–
Cash dividends – $10 per share	–	–	(2,500,000)	–
Balance, December 31, 1975	$5,000,000	$5,000,000	$10,972,007	$1,001,000

See accompanying notes to consolidated financial statements of bank subsidiary.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Years ended December 31,	
	1975	*1974*
Funds provided:		
From operations:		
Net earnings	$ 3,531,338	$ 4,189,857
Depreciation (including direct leased equipment)	210,303	240,711
Provision for loan losses	11,900	19,300
Deferred income taxes	53,633	236,917
Provided from operations	3,807,174	4,686,785
Increase in:		
Deposits	8,281,864	1,530,545
Federal funds purchased	1,000,000	–
Decrease in:		
Loans	12,040,472	–
Federal funds sold	5,000,000	–
Investment securities	–	2,106,915
Cash and due from banks	2,746,306	5,140,076
Other, net	283,376	–
Total funds provided	$33,159,192	$13,464,321
Funds used:		
Increase in earning assets:		
Loans	–	4,865,062
Federal funds sold	–	5,000,000
Investment securities	30,536,264	–
Additions to bank premises and equipment, net	79,428	44,891
Increase in direct leased equipment	43,500	–
Cash dividends	2,500,000	2,750,000
Other, net	–	804,368
Total funds used	$33,159,192	$13,464,321

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1975 and 1974

(1) Significant Accounting Policies

The accounting policies of The Illinois National Bank & Trust Co. of Rockford (a 97.7% owned subsidiary of Berkshire Hathaway Inc.) and its wholly-owned subsidiary, Brown Building Corporation, conform to generally accepted accounting principles and to general practice within the banking industry. The following is a description of the more significant accounting policies:

Consolidation

The consolidated financial statements include those of the Bank and its wholly-owned subsidiary. All significant intercompany transactions are eliminated in consolidation.

Investment Securities

Investment securities are stated at cost, adjusted for amortization of premium. Accretion of discount is not reflected in the accompanying statements and would not be material. Gains or losses on sales of investment securities are recognized only upon realization and are shown separately in the statements of earnings.

Consumer Credit Loans

Consumer credit loans are generally made on a discount basis. Unearned discount is taken into earnings over the terms of the respective loans using a method that approximates straight-line.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method for building and automobiles, and on an accelerated method for improvements and other equipment. Rates of depreciation are based on the following: buildings, 40 years; improvements and other equipment, 3-8 years.

Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are charged against operations as incurred.

Income Taxes

The Bank utilizes the accrual method of accounting for financial reporting purposes, but determines current taxable income on a cash basis. Investment tax credits are treated as a reduction of the provision for Federal income taxes in the year realized.

Provision for and Reserve for Loan Losses

The provision for loan losses is based on past loan loss experience, management's evaluation of the loan portfolio under current economic conditions, and such other factors as in management's best judgment, deserve current recognition in estimating loan losses.

(2) Investment Securities

A summary of investments by major classifications is as follows:

	Dec. 31, 1975 (In thousands)			Dec. 31, 1974 (In thousands)		
	Par value	Book value	Market value	Par value	Book value	Market value
U. S. Government—direct	$24,565	$24,181	$24,456	$ 565	$ 565	$ 567
U. S. Government—agencies	15,550	15,577	15,605	10,050	10,050	10,066
State and local municipalities	47,680	46,769	44,474	46,474	45,858	43,778
Other	5,029	4,327	4,252	4,312	3,846	3,550
	$92,824	$90,854	$88,787	$61,401	$60,319	$57,961

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

The market value decline in investment securities is considered to be a temporary condition, in view of the fact that management presently intends to hold the securities to maturity or until any loss recognized would not materially affect the results of operations.

Investment securities with a book value of $7,552,917 and $7,575,779 at December 31, 1975 and 1974, respectively, were pledged to secure public deposits and for other purposes.

(3) Loans

A summary of the major classifications of loans at December 31, 1975 and 1974 is as follows:

	1975	1974
Commercial loans	$27,331,810	$35,706,525
Consumer credit loans (less unearned discount of $2,286,776 in 1975 and $2,722,089 in 1974)	12,179,579	15,042,339
Floor plan loans	5,701,588	6,211,502
Real estate loans	13,576,010	13,893,176
	58,788,987	70,853,542
Less allowance for loan losses	707,735	719,918
	$58,081,252	$70,133,624

(4) Bank Premises and Equipment

Bank premises and equipment are recorded at cost less accumulated depreciation of $1,995,311 and $1,919,822 at December 31, 1975 and 1974, respectively. Depreciation expense totaled $109,324 for 1975 and $146,576 for 1974.

(5) Income Taxes

Accrued taxes and other liabilities in the accompanying balance sheets include deferred taxes of $596,502 and $542,869 at December 31, 1975 and 1974, respectively. Such deferred taxes result from timing differences arising from reporting taxable income on the cash basis. The Bank and its subsidiary join in the filing of a consolidated Federal income tax return with the parent company, Berkshire Hathaway Inc. The tax benefit of deductions by the parent has been passed to the Bank, as shown in the following schedules.

Taxes applicable to net earnings were as follows:

	1975	1974
Tax provision applicable to earnings before securities gains	$431,667	$759,929
Tax provision applicable to securities gains	25,867	88,380
	457,534	848,309
Less tax benefit from parent corporation applicable to:		
Earnings before securities gains	295,165	539,673
Securities gains	23,682	81,379
	318,847	621,052
Applicable income taxes, net	$138,687	$227,257

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

The components of consolidated income tax expense are as follows:

	1975	1974
Current income taxes:		
Federal	$314,523	$486,701
Less tax benefit from parent applicable to:		
Taxes currently payable	314,523	486,701
Recovery of prior taxes paid through net operating loss carryback	4,324	134,351
Total benefit from parent	318,847	621,052
	(4,324)	(134,351)
State	89,378	124,691
Total current income taxes	85,054	(9,660)
Deferred income taxes:		
Federal	60,517	222,635
State	(6,884)	14,282
Total deferred income taxes	53,633	236,917
Applicable income taxes, net	$138,687	$227,257

The sources of timing differences resulting in deferred income taxes and the tax effect of each were as follows:

	1975	1974
Accrued earnings and expense not reported for income tax purposes until collected or paid, net	$ 59,593	$185,795
Loan loss deductions for tax purposes in excess of (less than) that provided for financial reporting purposes	(5,960)	51,122
	$ 53,633	$236,917

The total income tax expense for 1975 amounted to $138,687, an effective rate of 3.8% ($227,257 and 5.1% in 1974). The reasons for the difference between the effective tax rate and the corporate Federal income tax rate of 48% are as follows:

	1975		1974	
	Amount	*Percent of pretax earnings*	*Amount*	*Percent of pretax earnings*
Tax expense at statutory rate	$1,761,612	48.0%	$2,120,215	48.0%
Increase (reduction) in taxes resulting from:				
Tax-exempt interest	(1,342,310)	(36.6)	(1,342,863)	(30.4)
State income taxes, net of Federal income tax benefits	42,896	1.2	72,266	1.6
Tax benefit from parent	(318,847)	(8.7)	(621,052)	(14.1)
Other—net	(4,664)	(.1)	(1,309)	—
Actual tax expense	$ 138,687	3.8%	$ 227,257	5.1%

It is not expected that the cash outlay for income taxes for any year through 1978 will exceed the income tax expense for such year.

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(6) Allowance for Loan Losses

For the years ended December 31, 1975 and 1974, there are certain changes in the method of presenting loans and the allowance for loan losses for financial statement purposes. Prior to such dates the valuation portion of the allowance for loan losses was included with the deferred tax and contingency portion of the allowance and shown with liabilities. At December 31, 1975 and 1974, loans are stated net of the valuation portion of the allowance for loan losses, the deferred tax portion ($211,543 for 1975 and $217,503 for 1974) has been included in other liabilities and the contingency portion ($307,802 for 1975 and $313,742 for 1974) has been included in undivided profits.

The following is a summary of activity in the valuation portion of the allowance for loan losses:

	1975	1974
Balance at beginning of year	$719,918	$734,495
Recoveries on loans previously charged off	27,179	7,299
Provision for loan losses	11,900	19,300
	758,997	761,094
Less loans charged off	51,262	41,176
Balance at end of year	$707,735	$719,918

(7) Pension and Profit-Sharing Plan

The Bank has a noncontributory pension plan and a profit-sharing plan for all officers and employees with two full years of service. Based upon the most recent actuarial report available (as of January 1, 1975), the pension fund assets exceeded the actuarial computed value of vested benefits and there was no unfunded past service cost liability. The Bank's policy is to fund pension costs as accrued. The total expense was $159,351 for 1975 and $128,247 for 1974.

The effect of the Retirement Income Security Act of 1974 on the Bank's pension expense provision and unfunded vested benefits, if any, has not been determined, and it is management's opinion that such effect will not be material to future years' earnings.

Berkshire Hathaway Inc.

LINES OF BUSINESS

Sources of Revenues:

Revenues reflected in the consolidated financial statements include those from (1) premiums earnings and investment income of the Insurance Group, plus (2) sales revenues from the textile business plus a minor amount of investment income of the parent company. The following table summarizes the total revenues derived from these two categories for the past five years, in thousands of dollars:

	1971	*1972*	*1973*	*1974*	*1975*
Insurance	$66,050	$66,556	$60,526	$ 68,776	$67,116
Textile	26,092	27,772	33,479	32,706	33,259
	$92,142	$94,328	$94,005	$101,482	$100,375

Sources of Net Earnings:

The unconsolidated bank subsidiary and the investment in Blue Chip Stamps represent additional significant sources of income for the Company. Sources of total net earnings on a pre-tax basis with total tax effects to the Company and its consolidated subsidiaries reflected as a separate item, were as follows for the past five years:

	(Thousands of Dollars)				
	1971	*1972*	*1973*	*1974*	*1975*
Insurance	$6,372	$10,701	$10,249	$ 892	$(2,327)
Textile	233	1,697	2,837	2,660	1,715
Unconsolidated bank subsidiary	2,192	2,700	2,782	4,093	3,450
Blue Chip Stamps	68	142	1,124	1,164	2,172
Interest and corporate administrative expenses	(648)	(770)	(1,966)	(2,324)	(2,268)
Realized investment gain (loss)	1,028	1,359	1,331	(1,908)	(2,888)
Total pre-tax income	9,245	15,829	16,357	4,577	(146)
Less: Total income taxes (credits)	1,559	3,703	3,497	(2,466)	(4,838)
Net Earnings	$7,686	$12,126	$12,860	$ 7,043	$ 4,692

Berkshire Hathaway Inc.

FIVE YEAR SUMMARY OF OPERATIONS

	1971	1972	1973	1974	1975
	(Dollars in thousands, except per share amounts)				
Insurance premiums written	$66,455	$57,950	$50,372	$60,997	$58,975
Insurance premiums earned	60,867	59,627	52,929	60,474	58,336
Net sales of textile products	26,011	27,742	33,411	32,592	32,883
Interest and dividend income	5,043	6,648	7,378	8,030	8,918
Insurance underwriting gain (loss)	1,409	4,284	3,319	(6,892)	(10,647)
Gross profit from sales of textile products	2,566	4,087	5,105	5,163	4,599
Interest expense	595	584	1,605	1,718	1,845
Income taxes (credit) applicable to insurance underwriting and textile operations	1,245	3,241	2,979	(2,010)	(4,141)
Net earnings from insurance underwriting and textile operations	4,712	8,387	8,141	3,239	1,261
Equity in net earnings of bank subsidiary	2,192	2,700	2,782	4,093	3,450
Equity in net earnings of Blue Chip Stamps	63	111	1,008	1,052	2,003
Earnings before realized investment gains (losses) and extraordinary items	6,967	11,198	11,931	8,383	6,714
Realized investment gains (losses) net of income taxes	719	928	929	(1,340)	(2,022)
Net earnings	7,686	12,126	12,860	7,043	4,692
Average shares outstanding	979,569	979,569	979,569	979,569	979,569
Per share:					
Earnings before realized investment gains (losses) and extraordinary items	$7.11	$11.43	$12.18	$8.56	$6.85
Net earnings	7.85	12.38	13.13	7.19	4.79

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Insurance Premiums Earned and Insurance Underwriting Gain (Loss)

Combined loss and expense ratios (which are the sum of the ratio of losses and loss expenses incurred to premiums earned plus the ratio of underwriting expenses, on a statutory basis, to premiums written) have been as follows for the Insurance Group for the past five years.

	NET PREMIUMS		RATIOS		
	Written (In thousands)	Earned	Losses and Loss Adj. Exp./ Earned Prem.	Underwriting Expenses/ Written Prem.	Combined Loss and Expense Ratio
1971	$66,455	$60,867	67.0	30.1	97.1
1972	57,950	59,627	62.0	29.7	91.7
1973	50,372	52,929	62.0	32.5	94.5
1974	60,997	60,574	77.8	32.0	109.8
1975	58,975	58,336	81.0	34.4	115.4

The combined loss and expense ratio is the traditional measure of underwriting results of property and casualty companies. In any year when that ratio exceeds 100, it generally indicates that unprofitable business has been underwritten.

The following table sets forth the net premiums written and earned by the Insurance Group in each of the past three years:

Operational Area		1973	1974	1975
		(Thousands of Dollars)		
Specialized Auto, General Liability and Other(1)	Written	$28,617	$36,738	$37,860
	Earned	29,969	34,436	38,144
Reinsurance(2)	Written	10,184	12,204	9,893
	Earned	11,996	12,938	10,188
Urban Auto(3)	Written	6,571	6,613	3,072
	Earned	6,120	7,902	3,332
Home State Companies(4)	Written	5,000	5,442	8,150
	Earned	4,844	5,298	6,672
Totals	Written	$50,372	$60,997	$58,975
	Earned	$52,929	$60,574	$58,336

(1) National Indemnity Company and National Fire & Marine Insurance Company less the Reinsurance Department of National Indemnity.

(2) Reinsurance Department of National Indemnity.

(3) Home and Automobile Insurance Company.

(4) Corporations organized in the jurisdictions of Nebraska, Minnesota, Texas and Iowa underwriting standard and preferred classes of fire and casualty insurance in those states.

MANAGEMENT'S DISCUSSION, *Continued*

The total underwriting gain or loss for the Insurance Group for the past three years is shown in the following table:

	1973		1974		1975	
	(Thousands of Dollars)					
	Statutory	*GAAP*	*Statutory*	*GAAP*	*Statutory*	*GAAP*
Specialized auto, general liability and other	$4,623	$4,409	$(2,119)	$(1,939)	$(5,201)	$ (6,728)
Reinsurance	715	353	(1,470)	(2,068)	(1,955)	(2,194)
Urban Auto	(834)	(878)	(1,761)	(2,183)	(941)	(848)
Home State	(801)	(565)	(702)	(702)	(1,100)	(877)
	$3,703	$3,319	$(6,052)	$(6,892)	$(9,197)	$(10,647)

The only difference between the Statutory and GAAP underwriting results is the change in amount of premium acquisition costs (underwriting expenses, i.e., commissions, etc.) which is deferred under GAAP. In each of the above years, the amount of such costs deferred at year-end decreased from the preceding year-end. The decreases were generally in expectation of unfavorable underwriting results from certain portions of the in-force book of business.

The premium rates at which Berkshire's Insurance Group, and, indeed, the entire property and casualty insurance industry, wrote its business in 1973, 1974 and 1975 were inadequate; rate increases did not keep pace with rates of inflation. Both monetary inflation and social inflation have impacted insurers. Social inflation is used here to encompass both higher and relatively more frequent jury awards to claimants as well as increased crime rates which increase the frequency of property loss claims.

The traditional businesses of National Indemnity and National Fire and Marine, as well as Berkshire's reinsurance business are preponderantly casualty type businesses. In casualty lines, losses incurred represent largely those of third-parties (as opposed to "first-party" losses, i. e., those sustained directly by the insured). For casualty business, the elapsed time between writing of coverages and settlement of claims tends to be longer than that for property lines of insurance. As a result, casualty underwriting loss ratios suffer more in highly inflationary times than do the ratios for property lines underwriting.

The venture by Home and Automobile Insurance Company into Florida resulted in the extremely high losses in 1974, in relation to earned premiums, of the Urban Auto business. In the traditional Cook County, Illinois business, rate increases were effected in both 1974 and 1975; premium volume (and thus, loss exposure) declined significantly but loss ratios did not. Home and Auto's management, rates, and underwriting practices have been restructured with a view to restoring underwriting profitability to this business; it is much too soon to know the results of these changes.

Operations of the Home State companies other than Cornhusker Casualty Company have to date yielded only underwriting losses. The Iowa operation completed only its second full year of operation in 1975 and has not yet reached viable size. Improvement was noted in the Texas operation in 1975; underwriting ratios deteriorated in the Minnesota operation. While the underwriting losses of the Home State companies increased in total dollars in 1975 over 1974, the overall loss ratio actually declined on higher 1975 volume.

Net Sales and Gross Profit from Sales of Textile Products

Consolidated net sales of $33.4 million – 1973, $32.6 million – 1974, and $32.8 million – 1975 give an appearance of stability in the textile operations; however, the 1975 figures require explanation inasmuch as they include $9.3 million from the Waumbec operation acquired during the year. Thus, a more revealing comparision shows sales from what comprised the textile operation in 1974 declined in 1975 by 28%. Both demand and price for our goods declined drastically, starting their downward trend in the fourth quarter of 1974 and continuing well into 1975, from the recent record high levels of early 1974. Some market recovery was noted in late 1975, which, combined with some gross profit realized from sale of Waumbec's products, stringent cost control efforts exerted by management of the textile operations, and the fact of relatively low fixed costs assignable to the operations, prevented a more significant decline in gross profits than that which occurred. Gross profit from sale of textile products at $4,599,000 in 1975 was 11% less in total than that realized in 1974.

Interest and Dividend Income

Interest and dividend income is earned almost entirely by the Insurance Group. The continuing increase in this category of income through 1974 was the result of increased investments; in 1975, the average yield on investments also increased. Interest and dividend income is related to average investments for the past five years in the following table, which excludes the investment in and dividends received from Blue Chip Stamps, accounted for by the equity method.

	Average Investments at cost	*Interest and Dividend Income*	*Average Per Cent Earned*
	(Amounts in Thousands)		
1971	79,117	5,043	6.37
1972	103,217	6,648	6.44
1973	117,516	7,378	6.28
1974	131,347	8,030	6.11
1975	136,500	8,918	6.53

The average per cent earned declined in 1973 and 1974 as a result of the increase in those years in the average investments in preferred and common stocks relative to the average investment in bonds, the converse was true in 1975; the income yield on the bonds tends to exceed that on the stocks. Investments for the past five years are categorized in the following table, at the average of their carrying values at the beginning and end of each year:

	Bonds, Treasury bills and other short-term obligations	*Preferred and common stocks*	*Total*
1971	68,906	10,211	79,117
1972	87,175	16,042	103,217
1973	81,311	36,205	117,516
1974	78,557	52,790	131,347
1975	88,787	47,713	136,500

Income Taxes (Credit) Applicable to Insurance Underwriting and Textile Operations

Each year there is a significant difference between pre-tax income reported in the financial statements, and income subject to tax. The difference arises principally from certain dividends received credits and from the fact that a considerable portion of income of the Insurance Group is produced by tax exempt bonds. For both 1974 and 1975 these items exceeded the pre-tax earnings from insurance underwriting and manufacturing operations and all other items of taxable income so that "net operating losses", as defined by the Internal Revenue Code, were reported for tax purposes. Berkshire Hathaway Inc. and its includible subsidiaries join in the filing of a consolidated Federal income tax return; the 1974 and 1975 consolidated net operating losses have been carried back to recover income taxes paid by members of the group for 1971, 1972 and 1973.

There are virtually no remaining paid and recoverable taxes which might benefit future net operating losses, if any.

MANAGEMENT'S DISCUSSION, *Continued*

Equity in Net Earnings of Bank Subsidiary

Berkshire's equity in net earnings of the Illinois National Bank and Trust Co. of Rockford ("the bank") represent approximately 98% of the bank's earnings. Financial statements of the bank are included elsewhere herein.

Income of the bank before income taxes and before securities transactions for the past three years is summarized below, in thousands of dollars:

	1973	1974	1975
Interest income	$9,324	$10,993	$10,797
Interest expense	4,351	4,969	5,195
Net interest earnings	4,973	6,024	5,602
Non-interest income	1,080	1,133	1,220
	6,053	7,157	6,822
Non-interest expenses	3,220	2,915	3,207
Income before taxes and before securities transactions	$2,833	$ 4,242	$ 3,615

1974 Compared to 1973

Loan demand was strong throughout 1974 and was accompanied by record high interest rates. Accordingly, interest income increased over 1973 as a result of both increased volume of earning assets and a higher yield thereon. Increased reliance on interest bearing time deposits as a source of funds and on increased average rate paid thereon caused the rise in interest expense in 1974.

Non-interest expense items declined in total in 1974 primarily as the result of a change instituted by local taxing authorities in assessing to Berkshire, as a shareholder of the bank, certain capital stock taxes previously assessed to the bank. In addition to elimination in 1974 of this particular expense item, an expense credit of $154,000 resulted in 1974 from reversal of this item previously accrued for 1973. While bank earnings increased as a result of this action by the taxing authorities, the net effect of this change was of no benefit to Berkshire, since taxes not theretofore paid by Berkshire appear as part of Berkshire's 1974 and 1975 selling and administrative expenses.

1975 Compared to 1974

Outstanding loans declined in 1975, resulting in less total interest income than in 1974. Interest bearing time deposits continued to increase resulting in higher interest costs. The combination resulted in a decline of $422,000 in net interest earnings in 1975 from the prior year.

The property tax expense credit in 1974 to "non interest" expense, discussed previously above, explains the major portion of the difference in that captioned item between 1974 and 1975. It is noted that non-interest expense of $3,207,000 compares not highly unfavorably with the second year prior (1973), when such captioned item totaled $3,220,000 including the capital stock tax.

MANAGEMENT'S DISCUSSION, *Continued*

Equity in Net Earnings of Blue Chip Stamps

Berkshire's equity in net earnings of Blue Chip Stamps as computed by the equity method for each of the past three years, based on the twelve month's operations of Blue Chip ended on or about November 30, have been as follows:

	1973	*1974*	*1975*
		(Amounts in Thousands)	
Equity in net earnings	$1,605	$1,548	$2,346
Applicable income taxes	(116)	(112)	(169)
Amortization of excess of cost over equity in net assets	(481)	(384)	(174)
Net equity in earnings	$1,008	$1,052	$2,003

The average number of shares of Blue Chip Stamps owned by Berkshire has increased in each of the past three years. Average shares owned in 1973. 1974 and 1975 were, respectively, 934,000, 1,144,670, and 1,325,233. Stated on the basis of per-average-share-owned, the above table is as follows:

	1973	*1974*	*1975*
Equity in net earnings	$1.72	$1.35	$1.77
Applicable income taxes	(.12)	(.10)	(.13)
Amortization of excess of cost over equity in net assets	(.52)	(.33)	(.13)
Net equity in earnings	$1.08	$0.92	$1.51

Realized Investment Gains (Losses)

Realized investment losses in 1975 aggregated $2,888,000 with a tax credit of $866,000 reducing the after-tax realized investment loss to $2,022,000. In 1974 and 1973 realized investment gains (losses) before taxes were, respectively, ($1,908,000) and $1,332,000; after taxes, ($1,340,000) and $929,000. Realization of investment gains or losses is determined by prevailing investment strategy as applied under changing economic conditions.

Berkshire Hathaway Inc.

DIRECTORS AND EXECUTIVE OFFICERS

WARREN E. BUFFETT, *Director and Chairman of the Board*
Chief Executive Officer of the Company

KENNETH V. CHACE, *Director*
President of the Company and Chief Operating Officer of the Textile Operations of the Company

MALCOLM G. CHACE, JR., *Director*
Retired, Former Chairman of the Board of Directors

J. VERNE MCKENZIE, *Director*
Vice President, Secretary and Treasurer of the Company

COMMON STOCK PRICES

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market. The high and low bid prices for the stock in each quarter of 1974 and 1975 is set forth in the following table. The quotations represent prices between dealers and do not include retail markup, markdown or commission. They do not represent actual transactions

		High	Low
1974	1st Quarter	76	72
	2nd Quarter	76	64
	3rd Quarter	64	49
	4th Quarter	49	40
1975	1st Quarter	51	38
	2nd Quarter	51	45
	3rd Quarter	60	41
	4th Quarter	43	38

The Company has not paid a dividend in the past two years.

Consolidated Statement of Income and Retained Earnings

Blue Chip Stamps

Fifty-two Weeks Ended February 28, 1976 and March 1, 1975 (Note 1)

	1976	1975
Revenues:		
Candy sales	$51,342,000	$42,907,000
Stamp service revenues (Note 2)	20,361,000	25,564,000
Merchandise promotions and incentive sales	15,210,000	11,022,000
Dividends and interest	4,913,000	7,738,000
Other revenues (Notes 4 and 5)	818,000	2,134,000
	92,644,000	89,365,000
Costs and expenses:		
Cost of sales and redemptions (Note 2)	52,116,000	54,912,000
Selling, general and administrative expenses	29,552,000	23,940,000
Interest and discount amortization	649,000	4,356,000
	82,317,000	83,208,000
Income before income taxes, equity in net income of Wesco Financial Corporation, securities gains and extraordinary credit	10,327,000	6,157,000
Provision for income taxes (Note 7)	(4,374,000)	(1,237,000)
Equity in net income of Wesco Financial Corporation (Notes 1 and 7)	3,092,000	2,588,000
Income before securities gains and extraordinary credit	9,045,000	7,508,000
Realized securities gains, less income tax effect (Notes 3 and 7)	8,000	254,000
Extraordinary credit (Note 7)	—	903,000
Net income	9,053,000	8,665,000
Retained earnings at beginning of year	60,551,000	53,129,000
Cash dividends of $.24 per share per year (Note 5)	(1,243,000)	(1,243,000)
Retained earnings at end of year	$68,361,000	$60,551,000
Amounts per share based on weighted average shares outstanding:		
Income before securities gains and extraordinary credit	$1.75	$1.45
Realized securities gains	—	.05
Extraordinary credit	—	.17
Net income	$1.75	$1.67

See accompanying notes to consolidated financial statements

Consolidated Statement of Changes in Financial Position

Blue Chip Stamps

Fifty-two Weeks Ended February 28, 1976 and March 1, 1975 (Note 1)

	1976	1975
Sources (uses) of cash, including short-term investments, from operations:		
Income before realized securities gains and extraordinary credit	$ 9,045,000	$ 7,508,000
Add (deduct):		
Depreciation and amortization	1,478,000	1,651,000
Equity in net income of Wesco Financial Corporation less dividends received, net of income taxes	(2,204,000)	(1,836,000)
Decrease (increase) in trade accounts receivable	(4,105,000)	428,000
Decrease (increase) in inventories	4,472,000	(1,412,000)
Increase (decrease) in trade accounts payable	628,000	(1,150,000)
Decrease in liability for unredeemed trading stamps	(1,048,000)	(6,593,000)
Increase in prepaid income taxes and other expenses	(7,773,000)	(828,000)
Increase (decrease) in income taxes payable	9,558,000	(856,000)
Cash provided (used) by operations before realized securities gains and extraordinary credit	10,051,000	(3,088,000)
Other sources of cash:		
Realized securities gains, less income tax effect	8,000	254,000
Extraordinary credit—federal income tax not payable due to offset of capital loss carry-forwards	—	903,000
Decrease in marketable equity securities (1976 amount is net of $4,978,000 net unrealized loss deducted from stockholders' equity)	10,469,000	29,420,000
Decrease (increase) in accounts receivable from securities transactions	1,740,000	(1,923,000)
Proceeds from disposal of property, fixtures and equipment, net of income taxes and gain on sales	131,000	1,868,000
Total	22,399,000	27,434,000
Other uses of cash:		
Additions to property, fixtures and equipment	1,195,000	907,000
Decrease (increase) in accounts payable from securities transactions	(110,000)	1,507,000
Payment of dividends	1,243,000	1,243,000
Purchase of stock of Wesco Financial Corporation	—	7,025,000
Purchase of debentures for retirement	120,000	4,041,000
Repayment of notes payable to bank	—	40,000,000
Other	112,000	—
Total	2,560,000	54,723,000
Increase (decrease) in cash, including short-term investments	$ 19,839,000	$(27,289,000)
Increase (decrease) in—		
Cash	$ 526,000	$(1,507,000)
Short-term investments	19,313,000	(25,782,000)
	$ 19,839,000	$(27,289,000)

See accompanying notes to consolidated financial statements

Consolidated Balance Sheet

Blue Chip Stamps

February 28, 1976 and March 1, 1975 (Note 1)

ASSETS	1976	1975
Cash	$ 2,032,000	$ 1,506,000
Short-term investments, at cost	24,695,000	5,382,000
Marketable equity securities, at the lower of cost or market at February 28, 1976 and at cost at March 1, 1975 (Note 3)	56,712,000	72,159,000
Accounts receivable	7,894,000	5,529,000
Merchandise and supplies inventories, at the lower of cost (first-in, first-out) or market	7,295,000	11,767,000
Prepaid income taxes and other expenses (Note 7)	14,462,000	6,689,000
Property, fixtures and equipment, net (Note 4)	8,290,000	8,273,000
Investment in Wesco Financial Corporation (Note 1)	28,588,000	26,307,000
Excess of cost over equity in net assets of See's Candy Shops, Incorporated, less accumulated amortization (Note 1)	15,487,000	15,883,000
	$165,455,000	$153,495,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable and accrued expenses	$ 6,227,000	$ 5,489,000
Income taxes payable (Note 7)	11,560,000	2,002,000
Liability for unredeemed trading stamps (Note 2)	71,135,000	72,183,000
6¾% Subordinated Debentures due 1978 (Note 5)	6,392,000	6,512,000
	95,314,000	86,186,000
Stockholders' equity (Notes 5 and 9)		
Common stock, par value $1.00		
Shares authorized—7,000,000		
Shares outstanding—5,179,000	5,179,000	5,179,000
Paid-in capital	1,579,000	1,579,000
Retained earnings	68,361,000	60,551,000
Net unrealized loss on marketable equity securities (Note 3)	(4,978,000)	—
Total stockholders' equity	70,141,000	67,309,000
	$165,455,000	$153,495,000

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

NOTE 1—Subsidiary companies:

The consolidated financial statements include the accounts of the Company and its 99%-owned subsidiary, See's Candy Shops, Incorporated (See's). The excess of cost over equity in the net assets of See's is being amortized over 40 years; amortization of $431,000 has been charged to selling, general and administrative expenses in each of the fiscal years ended in 1976 and 1975.

The Company's investment in Wesco Financial Corporation (Wesco), a savings and loan holding company, has increased from 44.6% at March 2, 1974 to 64.4% at March 1, 1975 and February 28, 1976. The investment is recorded at cost plus equity in Wesco's calendar-year net income, less taxes; the $18,131,000 and $18,699,000 excess of equity in the net assets of Wesco over cost at February 28, 1976 and March 1, 1975, respectively, is being amortized over 40 years. Summarized financial information of Wesco for the years ended December 31, 1975 and 1974 follows:

	December 31, 1975	December 31, 1974
Assets—		
Cash and marketable securities	$ 77,417,000	$ 53,065,000
Loans receivable, less unearned loan fees, unrealized profit and loans in process	373,059,000	389,065,000
Other assets	19,651,000	23,516,000
	$470,127,000	$465,646,000
Liabilities and stockholders' equity—		
Savings deposits	$360,070,000	$333,117,000
Other liabilities	36,839,000	62,238,000
Total liabilities	396,909,000	395,355,000
Stockholders' equity, partially appropriated	73,218,000	70,291,000
	$470,127,000	$465,646,000
Total revenues	$ 36,610,000	$ 35,180,000
Net income	$ 4,351,000	$ 3,927,000

	December 31, 1975	December 31, 1974
Blue Chip Stamps' equity therein—		
Average ownership	64.4%	60.5%
Share of net income	$ 2,800,000	$ 2,375,000
Income taxes thereon assuming ultimate distribution	(200,000)	(244,000)
Amortization of excess equity over cost	492,000	457,000
	$ 3,092,000	$ 2,588,000

Wesco's appropriated retained earnings at December 31, 1975 and 1974 include approximately $44,940,000 and $43,852,000 respectively of reserves on which no provision for federal income taxes has been made. If in the future these appropriations are used for any purpose other than to absorb bad debt losses, federal income taxes will be imposed at the then applicable rates. The Federal Savings and Loan Insurance Corporation, in connection with the insurance of savings deposits, requires savings and loan associations to maintain certain reserves which may be used only for the purpose of absorbing losses. In addition, associations must maintain certain reserves under California law. Such reserve requirements were met as of December 31, 1975 and 1974.

NOTE 2—Stamp service accounting:

The Company recognizes stamp service revenues upon issuance of its trading stamps and provides a liability account for unredeemed trading stamps consisting of estimates of the cost of merchandise and related redemption service expenses. The Company's estimated cost of future redemptions depends upon two factors: (1) the percentage of stamps issued which will ultimately be redeemed and (2) the future cost per stamp of the merchandise and redemption service expenses which will be required.

In its annual report for the year ended March 1, 1975, the Company explained that its accounting practice for many years had been to assume that 97.5% of stamps issued would ultimately be redeemed and to base its estimate of future redemption costs per stamp on the most recent information available. The Company indicated that both assumptions were considered less reliable than in previous years because of the recent substantial decline (approximately 80%) in its issuances of trading stamps and continuing increases in total redemption costs per stamp. Under such conditions it was thought that the current redemption rate might well be less than the 97.5% estimated with respect to prior years and that future redemption costs per stamp might well be higher than those projected. It was further noted that the Internal Revenue Service had proposed a substantial tax deficiency for the fiscal years ended in 1969 through 1974 (since settled—see Note 7) based partially on its contention that the Company's estimated stamp redemption rate was less than the 97.5% which had been assumed for many years in preparing financial statements and tax returns.

With additional experience, the Company in February 1976 reevaluated both factors affecting the estimated cost of future redemptions and made the following revisions in its current financial statements:

(1) The Company reduced its liability for unredeemed trading stamps, as of February 28, 1976, and increased net income for the year, to reflect a reduction in the total estimated number of stamps to be redeemed in the future, computed by modifying the Company's former assumption that 97.5% of all stamps issued will ultimately be redeemed. The modifications (i) as of the conclusion of the fiscal year ended in 1974, reduced by approximately 4% the total number of stamps then estimated to be redeemed in the future, and (ii) for the two subsequent fiscal years ended in 1975 and 1976, reduced the redemption expectancy, applicable to stamps issued in such years, to 93%. These reductions reflect the Company's present estimate that ultimate redemption rates are reduced by a decline in issuances, with most of the reduction occurring with respect to stamps issued after the decline, and that, accordingly, the Company will have to redeem about 97% of stamps issued before March 1974, and only 93% thereafter.

(2) The Company increased its provision for future redemption service expenses per stamp to reflect its present estimate that a lower volume of redemptions will cause these expenses to increase materially on a per-stamp basis.

The effect of the foregoing revisions after federal and state income taxes was to increase current year's net income $573,000, or $.11 per share. The liability for unredeemed trading stamps of $71,135,000 at February 28, 1976, included $47,878,000 for the cost of merchandise and $23,257,000 for redemption service expenses.

The Company expects stamp issuances to continue to decline and therefore, with additional experience, may make additional revisions of its redemption expectancy and costs in the future.

NOTE 3—Marketable equity securities:

Cost (first-in, first-out) and market value of marketable equity securities at February 28, 1976 and at March 1, 1975 are set forth below:

	February 28, 1976	March 1, 1975
Cost	$61,690,000	$72,159,000
Market value	56,712,000	54,212,000

Pursuant to Statement of Financial Accounting Standards No. 12 issued by the Financial Accounting Standards Board, the Company at February 28, 1976 established a $4,978,000 valuation allowance to reduce the amount of marketable equity securities shown in its balance sheet from historical cost to the lower of aggregate cost or market. The valuation allowance, which represented the excess of $7,246,000 of gross unrealized losses over $2,268,000 of gross unrealized gains, was charged directly to stockholders' equity (i.e., not included in the determination of net income). The amount charged was not reduced by the tax benefit that will result if losses are ultimately realized and offset by capital gains. At March 1, 1975 marketable equity securities were not required to be carried at the lower of aggregate cost or market, and accordingly they are carried at historical cost in the balance sheet.

Marketable equity securities, among other assets, are held primarily for the purpose of satisfying the Company's obligation to redeem outstanding trading stamps which, based on the Company's experience, will be presented for redemption over a number of years.

NOTE 4—Property, fixtures and equipment:

Following is a summary of property, fixtures and equipment, stated at cost:

	February 28, 1976	March 1, 1975
Land	$ 2,315,000	$ 2,323,000
Buildings	4,186,000	4,031,000
Furniture, fixtures and equipment	9,808,000	9,619,000
Leasehold improvements	3,867,000	3,893,000
	20,176,000	19,866,000
Less accumulated depreciation and amortization	11,886,000	11,593,000
	$ 8,290,000	$ 8,273,000

Depreciation and amortization of property, fixtures and equipment are provided by straight line and accelerated methods over the estimated useful lives of the assets. Total provisions amounted to $1,047,000 and $1,220,000 for the fiscal years ended in 1976 and 1975.

A $1,254,000 gain on the sale of the Company's Richmond, California warehouse is included in other revenues in the fiscal year ended in 1975.

NOTE 5—Debentures:

The indenture underlying the debentures requires three annual sinking fund payments of approximately $2,000,000 in November 1976, 1977 and 1978. However, as a result of an invitation for tenders and open-market purchases subsequent to February 28, 1976, the 1976 requirement will be reduced by approximately $1,000,000. During the fiscal years ended in 1976 and 1975, the Company realized gains of $7,000 and $311,000 in connection with purchases of debentures in anticipation of prior sinking fund requirements.

Under the terms of the indenture, the Company is permitted to pay cash dividends in any fiscal year in an amount not to exceed the greater of (a) 24 cents per share or (b) 25% of net income for the preceding fiscal year. Dividends may not be paid if the Company is in arrears in any sinking fund payments.

NOTE 6—Pension and profit sharing plans:

Employees of the Company and of its consolidated subsidiary who meet certain eligibility requirements are covered under either Company-sponsored noncontributory pension or profit sharing plans or union-sponsored pension plans. The Company-sponsored plans are funded annually, the cost for the fiscal years ended in 1976 and 1975 approximated $375,000 and $386,000 respectively. The total market value of the plans' assets exceeded the actuarially computed value of vested benefits at yearend by approximately $1,000,000. The plans are being amended to comply with the Employee Retirement Income Security Act of 1974 and for other purposes. The amendments are not expected to have a material effect on the consolidated financial statements.

NOTE 7—Taxes on Income:

The consolidated statement of income contains charges for income taxes as follows:

	Fiscal year ended in	
	1976	1975
Provision for income taxes	$4,374,000	$1,237,000
Charged against equity in net income of Wesco Financial Corporation	200,000	244,000
Charged against securities gains	4,000	284,000
Extraordinary credit, representing federal income tax not payable due to the offset of capital loss carry-forwards	—	(903,000)
Total taxes charged in income statement	$4,578,000	$ 862,000

These taxes are payable or recoverable as follows:

	Fiscal year ended in	
	1976	1975
Payable currently—		
Federal	$6,472,000	$ 788,000
State	1,572,000	789,000
	8,044,000	1,577,000
Recoverable in the future—		
Federal	(2,839,000)	(543,000)
State	(627,000)	(172,000)
	(3,466,000)	(715,000)
Total taxes charged in income statement	$4,578,000	$ 862,000

Of the above taxes, the amounts currently payable are included in income taxes payable on the consolidated balance sheet. The amounts recoverable in the future are included in prepaid income taxes and result from the following timing differences in the recognition of revenue and expense items on the books as compared to the tax returns:

	Fiscal year ended in	
	1976	1975
Deductible California franchise taxes over (under) those accrued on the books	$ (101,000)	$ 429,000
Deductible redemption expenses under those accrued on the books	(3,240,000)	(1,351,000)
Deferred taxes on undistributed earnings of Wesco Financial Corporation	133,000	113,000
Other timing differences	(258,000)	94,000
Total taxes recoverable in the future	$(3,466,000)	$ (715,000)

The provision for income taxes of $4,374,000 for the fiscal year ended in 1976 amounted to 42.4% of pre-tax income of $10,327,000; the provision of $1,237,000 for the prior fiscal year represented 20.1% of pre-tax income of $6,157,000. Following is a summary of the differences between the federal statutory rate and these effective percentages:

	Fiscal year ended in	
	1976	1975
Statutory federal income tax rate	48.0%	48.0%
Federal tax benefit from dividend exclusion	(13.7)	(33.8)
State income taxes net of federal income tax benefit	4.8	5.5
All other (net)	3.3	.4
Effective income tax rate	42.4%	20.1%

Investment tax credits, which have not been material, are recognized as the tax benefits are realized.

The consolidated balance sheet includes prepaid income taxes of $12,935,000 and $4,925,000 at February 28, 1976, and March 1, 1975, resulting primarily from (1) deducting certain redemption service expenses for tax purposes when stamps are redeemed and for book purposes when stamps are issued and (2) at February 28, 1976 a difference between book and tax accounting for the number of outstanding stamps expected to be redeemed.

In March 1976 the Company settled its disagreement with the Internal Revenue Service with respect to its income tax returns for the fiscal years ended in 1969 through 1974 resulting from the Service's contentions that the Company (1) overstated its liability for unredeemed stamps by overestimating the number of stamps issued which would ultimately be redeemed and (2) should change its tax accounting method to deduct a greater portion of its redemption service expenses for tax purposes when stamps are redeemed, rather than when they are issued. Throughout the period, the Company's financial statements and tax returns had been prepared on the basis of (1) the Company's expectation that 97.5% of all stamps issued would ultimately be redeemed and (2) a tax accounting method, previously approved by the Service, whereunder most of the Company's total expected redemption service expenses were permitted to be deducted when stamps were issued and the balance deducted when stamps were redeemed. The settlement with the Service, which is reflected in the financial statements for the year ended in 1976, was as follows:

(1) The Company, for tax purposes, agreed to reduce its accumulated provision for redemption of outstanding stamps and to increase taxable income for the fiscal year ended in 1974 to assume a reduction of 11% in the total number of outstanding stamps then estimated to be redeemed in the future. This resulted in a tax deficiency, before interest, of approximately $3,400,000. The Company believes that the 11% reduction in outstanding stamps expected to be redeemed for tax purposes is unreasonably high. It consented to the settlement only because of the prospective expense and risk of litigation and because the reduction was of a type whereunder any error would be adjusted in later years, resulting only in a loss of the use of funds. Accordingly, the Company, as explained in Note 2, revised its financial statements to reflect a reduction of only approximately 4%, instead of 11%, in the number of stamps that would ultimately be redeemed.

(2) The Company also agreed to change its tax accounting method effective with the fiscal year ended in 1974 to deduct a greater portion of redemption service expenses when stamps are redeemed, as opposed to when they are issued, with an expected tax effect of approximately $3,500,000.

The Company expects to be assessed additional California franchise taxes in the near future based upon the federal settlement.

In the fiscal year ended in 1976, prepaid income taxes and income taxes payable were increased by approximately $4,500,000 for the federal and California effect of the settlement. The increase in prepaid income taxes was subsequently reduced by approximately $1,300,000 as a result of the adjustment to the financial statements to reflect a reduction in the number of stamps to be redeemed explained in Note 2. In addition, approximately $3,000,000 of the settlement is payable without interest in equal annual installments from 1977 through 1983 and will be included in prepaid income taxes and income taxes payable as the installments become due. The settlement had no effect on the consolidated statement of income where tax deficiencies constituted timing, rather than permanent, differences.

NOTE 8—Lease commitments and rental expense:

At February 28, 1976 minimum rental commitments are as follows:

Fiscal year ending in—	
1977	$2,541,000
1978	2,202,000
1979	1,963,000
1980	1,767,000
1981	1,308,000
Five fiscal years ending in—	
1986	2,937,000
1991	961,000
1996	107,000

Net rental expenses were $4,420,000 and $4,070,000 for the fiscal years ended in 1976 and 1975. Rentals applicable to candy operations are generally determined on the basis of a fixed percentage of sales subject to a specific minimum rental. Percentage rental expenses in excess of minimum rentals, which are included above, were $1,547,000 and $1,288,000 for the fiscal years ended 1976 and 1975.

Substantially all of the candy subsidiary's leases are, based on current assumptions, considered "financing leases" as defined by the Securities and Exchange Commission. The respective present values of aggregate rental commitments (including estimated future percentage rentals) of these leases were approximately $12,602,000 and $11,315,000 at February 28, 1976 and March 1, 1975. In computing present values, prime interest rates ranging from 1.5% to 12% were used and averaged approximately 6% in each of the fiscal years. The effect on net income, assuming the leases had been capitalized at inception, would not have been material.

NOTE 9—Legal proceedings:

Pursuant to an antitrust action filed by the federal government a consent final judgment was entered in 1967 providing for, among other things, a plan to offer for sale one-third of the Company's California trading stamp business located within a contiguous geographical area in Southern California. That portion of the judgment has been suspended indefinitely by stipulation and court order signed in March 1976.

The Company is a defendant in a purported class action filed March 1, 1971 to recover for stamp savers monies collected by it as reimbursement for California sales taxes on redemption of stamps. Plaintiffs claim that redemption transactions are not taxable and that all such collections should be returned or, alternatively, that such collections exceeded the tax properly payable and such excess should be returned. The

Company has paid sales taxes to the state equal to its reimbursement collections. The Company has asserted claims against the state for reimbursement of all or part of any recovery by plaintiffs. Following denial of these claims by the state, the Company cross-complained against the state seeking indemnity. The original class action complaint against the Company was amended to assert fraud and to seek punitive damages. On June 1, 1973 two partial summary judgments were entered by way of interlocutory orders, neither of which has yet become final. The first was in favor of the Company to the effect that the redemption transactions were taxable. The second was in favor of plaintiffs to the effect that the Company's collections exceeded the tax properly payable. In the opinion of counsel for the Company, the second partial summary judgment was erroneous. The class action complaint was also amended effective September 19, 1974 to assert, in substance, that the Company's predecessor had engaged in similar conduct from 1961 until its merger into the Company in 1968, and that the Company must respond in respect of the alleged liability of its predecessor to plaintiffs and the persons they purport to represent for overreimbursement of sales taxes. On October 24, 1975 the California Supreme Court granted the petition of Blue Chip Stamps for an alternative writ of mandate to determine (1) whether the trial court properly certified the action as a class action and set it for trial without any notice to members of the purported class and (2) whether or not an order for partial summary judgment previously entered was erroneous. Proceedings in the trial court are stayed pending final determination of the mandate proceedings in the California Supreme Court. Issues relating to the class action aspects of the case remain unresolved along with a number of issues of fact. Maximum liability in respect of this action as amended may be as high as $17,000,000 less the amount of any money which may be recovered on the claims against the state. Counsel believes the prospects for some such recovery to be good. In the opinion of counsel for the Company, substantial defenses are available, but counsel cannot predict the ultimate outcome of the action.

A purported class action was filed under federal securities laws on November 10, 1970 against the Company and certain of its present and former stockholders and directors, on behalf of retailer users of Blue Chip Stamps who failed to purchase securities of the Company in a 1968 offering to retailer users. The complaint alleged damages to plaintiffs of $21,400,000, together with exemplary damages of $25,000,000, interest, attorneys' fees and costs, and prayed that plaintiffs have the right to purchase securities of the Company on the terms of the 1968 offering. After hearings in the United States District Court and the United States Court of Appeals for the Ninth Circuit, the Supreme Court of the United States in a decision rendered on June 9, 1975 held that the purported class did not have standing to bring such an action. Accordingly, the federal action is concluded. On June 5, 1974 the Company was served with a complaint in a substantially identical action based on California corporate and common law filed in Los Angeles County Superior Court on June 21, 1971. Although plaintiffs are pursuing the state court action, in the opinion of counsel for the Company, upon the facts now known, the present state of the law and the decision of the Supreme Court in the federal action, there appear to be substantial defenses on the merits.

Report of Independent Accountants

Price Waterhouse & Co.

606 SOUTH OLIVE STREET LOS ANGELES, CALIFORNIA 90014
213-625-4400

April 12, 1976

To the Board of Directors and Stockholders of Blue Chip Stamps

We have examined the consolidated balance sheet of Blue Chip Stamps and its consolidated subsidiary as of February 28, 1976 and March 1, 1975, and the related consolidated statements of income and retained earnings and of changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Wesco Financial Corporation which is accounted for on the equity method in the consolidated financial statements (Note 1). These statements were examined by other independent accountants whose report thereon has been furnished to us. Our opinion expressed herein, insofar as it relates to the amounts included for Wesco Financial Corporation, is based solely upon such report.

As explained in Note 9 to the accompanying consolidated financial statements, the Company is subject to certain legal proceedings.

As described in Note 3 to the accompanying consolidated financial statements, the Company changed its method of accounting for marketable equity securities as of February 28, 1976.

In our opinion, based on our examinations and the report of other independent accountants and subject to the effect, if any, of the legal proceedings referred to in the second paragraph above, the consolidated financial statements present fairly the financial position of Blue Chip Stamps and its consolidated subsidiary at February 28, 1976 and March 1, 1975, and the results of their operations and the changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles consistently applied during the period, except for the change, with which we concur, referred to in the preceding paragraph.

Price Waterhouse & Co

WESCO FINANCIAL CORPORATION

Annual report 1975

Headquarters building of Wesco Financial Corporation and Mutual Savings — Pasadena's City Hall in foreground

MUTUAL SAVINGS AND LOAN ASSOCIATION **PASADENA**

Head Office: 315 EAST COLORADO BOULEVARD • PASADENA, CALIFORNIA • 91109

Branches: Glendale, Covina, West Arcadia, Corona del Mar, Canoga Park, Thousand Oaks, Vista, Santa Ana, Capistrano-San Clemente, Channel Islands, Fountain Valley, Lake San Marcos, Upland, Cerritos and Fallbrook, California

TO THE STOCKHOLDERS OF WESCO FINANCIAL CORPORATION

Consolidated net earnings of Wesco Financial Corporation and its subsidiaries for 1975 amounted to $4,351,000 ($1.83 per share) compared to $3,927,000 ($1.65 per share) in 1974. Quarterly earnings per share were:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1975	$ .36	.36	.54	.57	1.83
1974	.48	.40	.44	.33	1.65

Total savings in Mutual Savings increased $26,953,000 in 1975 compared with a decrease of $12,413,000 in 1974. Out-of-state savings decreased $5,261,000 in 1975 and $16,257,000 in 1974. Most of the decrease in out-of-state savings in 1975 occurred during the first six months of the year. At December 31, 1975, out-of-state savings totaled $52,313,000 (14.7% of savings) compared with $57,574,000 (17.3% of savings) at December 31, 1974. The amount of out-of-state savings appears to have stabilized.

Savings deposits are summarized at December 31 by interest rates as follows:

	1975	1974	1973
5¼ %	38%	36	35
5½	1	2	3
5¾	3	3	6
6	10	23	42
6½	11	8	5
6¾	4	3	1
7	1	1	1
7½	27	22	7
7¾	5	—	—
Over 7¾	—	2	—
	100%	100	100

Cost of savings and cost of funds (savings and borrowings) continued to increase in 1975 as did the yield on the loan portfolio of Mutual Savings.

	1975	1974	1973	1972	1971
Cost of Savings	6.29%	6.00	5.60	5.56	5.51
Cost of all Funds	6.41	6.25	5.69	5.59	5.71
Yield on Loans at year end	7.55	7.36	7.17	7.03	6.82

We expect the cost of savings to rise gradually during 1976 because of the increased funds being converted to and deposited in certificate accounts paying 7½% and 7¾%. Yield on loans will also increase.

Real estate loans made during 1975 totaled $36,317,000 compared with $31,998,000 in 1974. Loans in process and firm loan commitments, which at December 31, 1974 were $3,240,000, have decreased to $1,643,000 at December 31, 1975.

The liquid assets of Wesco were markedly improved during 1975, with cash and marketable securities at year end totaling $77,417,000 compared with $53,065,000 at December 31, 1974. Also notes payable were reduced during 1975 by the sum of $24,765,000 and at year end were $26,210,000.

Mutual Savings and Wesco, which at December 31, 1974 had invested $12,900,000 in public utilities preferred stocks, increased such investments during 1975 and at year end had invested $23,206,000 ($267,000 in Wesco) in such stocks with an annual yield of 10.20%. Mutual Savings, by regulation, is limited to 5% of assets in the amount of preferred stocks of public utilities it may own. Its present investments approximate that amount. During the last quarter of 1975, Mutual Savings purchased municipal bonds and at year end had invested $4,554,000 in such securities with an annual yield of 7.11%.

For several years, Mutual Savings constructed homes at its Friendly Valley development. No homes were constructed during 1975. 91 units of homes previously constructed were sold and, at December 31, 1975, 7 units remained unsold, 6 of which were in escrow. A portion of the land in Friendly Valley was sold in 1975 to a responsible builder, who has completed the construction of 58 residences which are presently being sold. As such residences are sold, Wesco will recognize its profit of $198,000 on the land sale. We expect to dispose of the remaining land at Friendly Valley to builders for development, rather than building for our own account.

We continue to market portions of property owned at Lake San Marcos in San Diego County, having sold in 1975 one parcel of 195 acres for the sum of $614,000 resulting in a profit of $208,000, which is carried as unrealized profit due to the low down payment. We expect to dispose of substantially all of our remaining vacant land at Lake San Marcos during 1976, retaining our one-half interest in a modern shopping center, motel and restaurant.

During 1975 Mutual Savings opened three new branch offices in Upland, Cerritos and Fallbrook, bringing the total number of Mutual Savings offices to sixteen. Four new branch offices were opened in 1974 and three in 1973.

On January 20, 1976 Wesco increased its regular quarterly cash dividend from 15¢ to 17½¢, payable March 11, 1976 to holders of record at the close of business on February 20, 1976.

A "Summary of Operations" for a five-year period is presented on page 2, followed by "Management's Discussion and Analysis" of that Summary. The purpose of the Summary and Discussion is to enable investors to compare periodic results of operations and to assess the source and probability of earnings.

Louis R. Vincenti

LOUIS R. VINCENTI
Chairman of the Board and President

WESCO FINANCIAL CORPORATION AND SUBSIDIARIES

Summary of Operations

Year ended December 31, 1975 and four prior years

	1975	1974	1973	1972	1971
Investment income:					
Interest on loans	**$ 28,438,000**	28,463,000	27,450,000	25,318,000	25,117,000
Interest on marketable securities	**3,171,000**	3,202,000	2,950,000	2,362,000	1,740,000
Dividends on common and preferred stocks	**1,953,000**	974,000	463,000	185,000	—
Interest and dividends on investments required by law	**519,000**	533,000	462,000	251,000	388,000
Total investment income	**34,081,000**	33,172,000	31,325,000	28,116,000	27,245,000
Cost of money:					
Interest on savings deposits	**21,844,000**	20,419,000	20,001,000	19,304,000	17,298,000
Interest on notes payable	**2,628,000**	3,364,000	1,313,000	611,000	3,105,000
Total cost of money	**24,472,000**	23,783,000	21,314,000	19,915,000	20,403,000
Margin on investments	**9,609,000**	9,389,000	10,011,000	8,201,000	6,842,000
Loan fees and service charges	**1,362,000**	1,542,000	1,786,000	2,662,000	1,684,000
Operations and net gains from sales of real property	**909,000**	593,000	831,000	622,000	320,000
Rental of office premises, net	**288,000**	206,000	303,000	261,000	238,000
Net gains or (losses) on sales of marketable securities	**(62,000)**	(429,000)	(72,000)	2,000	51,000
Other income, net	**32,000**	96,000	116,000	124,000	111,000
	12,138,000	11,397,000	12,975,000	11,872,000	9,246,000
General and administrative expenses	**4,710,000**	4,208,000	3,702,000	3,436,000	3,127,000
Earnings before taxes on income	**7,428,000**	7,189,000	9,273,000	8,436,000	6,119,000
Taxes on income:					
Current	**3,735,000**	3,262,000	4,263,000	3,018,000	2,530,000
Deferred	**(658,000)**	—	402,000	1,082,000	465,000
	3,077,000	3,262,000	4,665,000	4,100,000	2,995,000
Net earnings	**$ 4,351,000**	3,927,000	4,608,000	4,336,000	3,124,000
Per share*	**$ 1.83**	1.65	1.94	1.83	1.32
FINANCIAL DATA AT YEAR END					
Total assets	**$470,127,000**	465,646,000	451,980,000	448,240,000	423,969,000
Real estate loans	**$371,041,000**	386,398,000	387,165,000	367,679,000	356,933,000
Savings accounts	**$360,070,000**	333,117,000	345,530,000	361,272,000	329,782,000
Shareholders' equity	**$ 73,218,000**	70,291,000	67,551,000	64,018,000	59,682,000
Book value per share*	**$ 30.85**	29.62	28.46	26.98	25.15

*Per share earnings and book value per share are based on 2,373,269 shares outstanding at December 31, 1975.

Management's Discussion and Analysis of Summary of Operations

The accompanying Summary of Operations covers the five years ended December 31, 1975.

The principal business of Wesco Financial Corporation (Wesco) is the ownership of all of the outstanding stock of Mutual Savings and Loan Association (Mutual Savings), which operates sixteen offices in Southern California. Wesco also owns and operates a Pasadena business block in which its head office and the head office of Mutual Savings are located. This block is fully improved with a 9-story modern office building, a 420-car garage and four retail stores. Wesco invests its cash funds in marketable securities and at December 31, 1975 had so invested the sum of $14,026,000. Mutual Savings' principal business is the lending of money secured by first liens on real estate (principally residential) to enable borrowers to purchase, construct or refinance real property. Funds are provided by savings deposits, principal payments on existing loans, borrowings from banks and operations.

INTEREST ON LOANS. This source of income is dependent upon the amount of loans and the yield thereon. The yields at December 31, 1975, 1974 and 1973 were 7.55%, 7.36% and 7.17% respectively. Total real estate loans outstanding at the end of such years were $371,041,000, $386,398,000 and $387,165,000.

INTEREST ON MARKETABLE SECURITIES. Investments have consisted principally of certificates of deposit of major banks, bankers acceptances, United States Government bonds, notes, bills, agency securities and municipal bonds. The variation in income shown on the accompanying Summary is accounted for by the varying amounts invested and the varying yields obtained in the particular year. The amount invested in marketable securities from time to time is dependent on the cash flow available for investment and the amount committed for investment in real estate loans.

DIVIDENDS ON COMMON AND PREFERRED STOCKS. In May, 1973 $6,785,000 was invested in 271,000 shares of common stock of Crocker National Corporation. The investment at December 31, 1974 was $5,079,000 and at December 31, 1975 was $1,853,000. 70,100 shares were sold in 1974 and 128,000 shares were sold in 1975 at approximate cost. The remaining 72,900 shares were sold in 1976 at a loss of $85,000.

Commencing in April, 1974 Wesco and Mutual Savings purchased public utility preferred stocks, and at December 31, 1974 had invested $12,900,000 ($267,000 by Wesco) with an annual yield of 9.77%. At December 31, 1975 $23,206,000 ($267,000 by Wesco) had been invested with an annual yield of 10.20% and a market value of $23,825,000, which at February 28, 1976 had increased to $25,008,000. The income on common and preferred stocks reflected in the accompanying Summary is that earned in the particular year from the securities held. 85% of the dividend income from stocks is deductible in computing Federal Income Taxes. Mutual Savings, by regulation, may invest in preferred stock of public utilities in an amount up to 5% of its assets. At December 31, 1975 Mutual Savings' investments in preferred stocks approximate that amount.

The market value of preferred stocks varies as interest rates vary. Since interest rates at 1975 year end were somewhat lower than the rates at time of purchase, the market value of our preferred stocks increased above cost. Interest rates continued to decline in 1976 resulting in a further increase of market value.

INTEREST AND DIVIDENDS ON INVESTMENTS REQUIRED BY LAW. This source of income consists of dividends received on stock of the Federal Home Loan Bank of San Francisco and interest received on our secondary reserve held by the Federal Savings and Loan Insurance Corporation. A dividend of $189,000 was declared in 1973, $229,000 in 1974 and

$198,000 in 1975 all in the fourth quarter. The variation in amount of interest on the secondary reserve has been nominal.

INTEREST ON SAVINGS DEPOSITS. Savings at December 31, 1972 which totaled $361,272,000, decreased in 1973 to $345,530,000 and to $333,117,000 at the end of 1974, and increased to $360,070,000 at the end of 1975. Although savings declined during 1973 and 1974, interest paid increased due to higher rates, which became effective July 1, 1973, and to substantial funds being converted from maturing lower-rate certificates to certificates bearing higher interest rates. The substantial increase in the amount of interest paid on savings deposits in 1975 was occasioned by increase in total savings and a continuation of conversion of lower-rate certificates to certificates bearing 7½% and 7¾%.

INTEREST ON NOTES PAYABLE. The variation in interest on notes payable is due to fluctuations in amounts borrowed from time to time and varying rates paid. Rates of interest on borrowings varied in 1975 from 7¼% to 10½%, in 1974 from 7½% to 12% and in 1973 from 7½% to 9¾%.

MARGIN ON INVESTMENTS. Margin on investments is the difference between total investment income and the cost of money, and is made up of the items discussed above. The $622,000 decrease in margin between 1974 and 1973 is the result of an increase in the cost of money by $2,469,000, with investment income increasing by only $1,847,000. The margin increased in 1975 by $220,000, with total investment income increasing $909,000 and total cost of money increasing $689,000.

LOAN FEES AND SERVICE CHARGES. This income was derived from the following sources:

	1975	1974	1973
Loan Fees	$ 721,000	858,000	855,000
Commitment fees	—	89,000	180,000
Escrow and clerical fees	47,000	102,000	139,000
Prepayment charges	314,000	334,000	341,000
Late charges	82,000	59,000	152,000
Other charges	198,000	100,000	119,000
	$1,362,000	1,542,000	1,786,000

OPERATIONS AND NET GAINS FROM SALES OF REAL PROPERTY. Mutual Savings, over a period of years, has acquired foreclosed real property including vacant land. Some vacant land has been disposed of from time to time and, on other occasions, residential units were built thereon and sold. During 1973, 38 residential units were sold, 17 of which had been constructed by it and in 1974, 53 units were sold of which 45 had been constructed by it and in 1975, 96 were sold of which 91 had been constructed by it. Parcels of vacant land were sold in 1973 and 1974 resulting in profits of $495,000 and $215,000. In the fourth quarter of 1975, a profit on vacant land of $256,000 was recognized on a sale that had been made in 1969. The variation in the sale of residences and of vacant land accounts for the variation in the income shown on the accompanying Summary.

RENTAL OF OFFICE PREMISES, NET. Substantially all of this income is derived from the Pasadena business block owned by Wesco in which the head office of Mutual Savings is located. The decrease from $303,000 in 1973 to $206,000 in 1974 is attributable to a $32,000 increase in expenses and the loss, at December 31, 1973, of a tenant occupying 26,000 square feet of space (20% of total rentable space). At 1974 year end, 9,800 square feet of space was vacant compared with 7,900 square feet of vacant space at 1975 year end. Net rental income in 1975 improved by $82,000, to a total of $288,000 by reduction in unrented space and increased rentals obtained, despite an increase in costs of operation of $48,000.

NET GAINS (LOSSES) ON SALES OF MARKETABLE SECURITIES. A loss of $429,000 taken on sale of securities in 1974 is accounted for by two transactions. In order to improve the quality and yield on public utility preferred stocks owned, some sales were made at a loss of $171,000 and the funds reinvested in other preferred stocks considered of better quality and providing a higher yield. Government and agency obligations were sold at a loss of $256,000 and proceeds reinvested so as to reduce the time to maturity. The loss of $62,000 in 1975 is due principally to sales of securities with the proceeds being used to purchase more desirable issues.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses increased $506,000 in 1974 and $502,000 in 1975 as compared to the respective prior years. Business expenses were 12.9% of gross income in 1975, 12% in 1974 and 10.8% in 1973. The increases were occasioned principally by inflation, the expense of opening and operating four additional offices in 1974, three additional offices in 1975 and the cost of computerizing our accounting system.

TAXES ON INCOME. Taxes on income were 41.4% of earnings before taxes on income in 1975, 45.4% in 1974 and 50.3% in 1973. Total tax expense varies with the increase or decrease in pre-tax accounting income adjusted for permanent differences (generally non-taxable revenue or non-deductible expense items). The main reason for the decreasing effective tax rates is the 85% dividends received deduction on common and preferred stock. This deduction has increased as the investment in preferred stock has increased.

A reconciliation of total income tax and the amount computed by applying the U. S. Federal Income Tax rate of 48% to earnings before taxes on income follows:

	1975	1974	1973
Computed "expected" Federal taxes	$3,565,000	3,451,000	4,451,000
Increase (reductions) in taxes resulting from:			
Net gains on sales of foreclosed real property	(278,000)	(219,000)	(386,000)
State franchise tax net of Federal income tax benefit	418,000	422,000	606,000
Dividends received deduction on common and preferred stocks	(796,000)	(397,000)	(189,000)
Other permanent differences	168,000	5,000	183,000
Taxes on income	$3,077,000	3,262,000	4,665,000

Deferred tax expense was $402,000 in 1973, nil in 1974 and ($658,000) in 1975. The decrease in deferred taxes was caused principally by the decrease in loan fees and accrued investment income recognized for financial statement purposes and the increase in loan fees and investment income recognized for tax purposes.

STOCK MARKET DATA. The following table indicates the quarterly high and low prices for Wesco's capital stock on the New York Stock Exchange for the last two years:

1975			1974	
High	Low	Quarter Ended	High	Low
11¾	8⅜	March 31	15	11⅛
12	10⅞	June 30	15	9⅝
11⅞	9	September 30	13½	6¼
10⅛	8⅞	December 31	9¾	7½

A copy of Form 10-K for 1975, filed with the Securities and Exchange Commission, is available without charge upon a stockholder's written request addressed to Mrs. Dolores Henderson, Assistant Secretary, Wesco Financial Corporation, 315 East Colorado Boulevard, Pasadena, California 91109.

Consolidated Balance Sheets

December 31, 1975 and 1974

ASSETS	1975	1974
Cash	$ 3,584,000	1,067,000
Marketable securities (notes 3 and 11)		
Certificates of deposit	40,000	24,010,000
United States Government and agency obligations and other marketable securities, at amortized identified cost (quoted market, $48,923,000 in 1975 and $9,953,000 in 1974)	48,734,000	10,009,000
Investment in common stocks (quoted market, $1,567,000 in 1975 and $3,039,000 in 1974)	1,853,000	5,079,000
Investment in preferred stocks (quoted market, $23,825,000 in 1975 and $11,831,000 in 1974)	23,206,000	12,900,000
Loans receivable, less unearned loan fees, unrealized profit and loans in process (notes 2 and 3)	373,059,000	389,065,000
Accrued interest and dividends receivable	1,581,000	1,935,000
Properties purchased and held for investment, at cost	288,000	661,000
Properties acquired through foreclosure by Mutual Savings and held for sale, at cost less allowance for losses, $251,000 in 1975 and $280,000 in 1974	3,286,000	5,819,000
Investments required by law:		
Investment in stock of Federal Home Loan Bank, at cost (note 3)	3,967,000	3,745,000
Prepayments to FSLIC secondary reserve	4,792,000	4,863,000
Office properties and equipment, net (note 5)	5,080,000	5,140,000
Prepaid expenses and sundry assets, at cost	657,000	1,353,000
	$470,127,000	465,646,000

LIABILITIES AND STOCKHOLDERS' EQUITY	1975	1974
Cash disbursements to be funded at bank	$ 646,000	1,248,000
Savings deposits	360,070,000	333,117,000
Notes payable (note 3)	26,210,000	50,975,000
Advances by borrowers for taxes and insurance	779,000	1,129,000
Accounts payable and sundry accrued expenses	1,032,000	996,000
Taxes on income (note 4):		
Current	981,000	41,000
Deferred	7,191,000	7,849,000
Total liabilities	396,909,000	395,355,000
Stockholders' equity (notes 4, 7 and 8):		
Capital stock of $1 par value per share. Authorized 2,500,000 shares; issued 2,373,269 shares	2,373,000	2,373,000
Capital surplus arising from stock dividends	28,066,000	28,066,000
Retained earnings	42,779,000	39,852,000
Total stockholders' equity	73,218,000	70,291,000
Commitment and contingent liabilities (notes 6 and 10).		
	$470,127,000	465,646,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Earnings

Years ended December 31, 1975 and 1974

	1975	1974
Investment income:		
Interest on loans	$ 28,438,000	28,463,000
Interest on marketable securities	3,171,000	3,202,000
Dividends on common and preferred stocks	1,953,000	974,000
Interest and dividends on investments required by law	519,000	533,000
Total investment income	34,081,000	33,172,000
Cost of money:		
Interest on savings deposits	21,844,000	20,419,000
Interest on notes payable	2,628,000	3,364,000
Total cost of money	24,472,000	23,783,000
Margin on investments	9,609,000	9,389,000
Loan fees and service charges	1,362,000	1,542,000
Operations and net gains from sales of real property (note 9)	909,000	593,000
Rental of office premises, net	288,000	206,000
Net losses on sales of marketable securities	(62,000)	(429,000)
Other income, net	32,000	96,000
	12,138,000	11,397,000
General and administrative expenses	4,710,000	4,208,000
Earnings before taxes on income	7,428,000	7,189,000
Taxes on income (note 4):		
Current	3,735,000	3,262,000
Deferred	(658,000)	—
	3,077,000	3,262,000
Net earnings	$ 4,351,000	3,927,000
Earnings per capital share based on 2,373,269 shares	$ 1.83	1.65

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

Years ended December 31, 1975 and 1974

	1975	1974
Capital stock	$ 2,373,000	2,373,000
Capital surplus arising from stock dividends	28,066,000	28,066,000
Retained earnings:		
Appropriated (notes 4 and 8):		
Beginning of year	43,042,000	42,446,000
Allocation of net earnings	1,088,000	596,000
End of year	44,130,000	43,042,000
Unappropriated (note 7):		
Beginning of year	26,049,000	23,905,000
Cash dividends declared and paid	(1,424,000)	(1,187,000)
Allocation of net earnings	3,263,000	3,331,000
End of year	27,888,000	26,049,000
Less stock dividends at market value	(29,239,000)	(29,239,000)
Total retained earnings	42,779,000	39,852,000
Total stockholders' equity	$ 73,218,000	70,291,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1975 and 1974

	1975	1974
Funds provided:		
Net earnings	$ 4,351,000	3,927,000
Charges (credits) to earnings not requiring (providing) funds:		
Depreciation and amortization	335,000	314,000
Interest on savings deposits credited to savings accounts	16,611,000	14,810,000
FSLIC primary premium transferred from secondary reserve	88,000	86,000
Deferred income taxes (note 4)	(658,000)	—
Amortization of fees and discounts	(342,000)	(409,000)
Recognition of unrealized profit on real property	(814,000)	(410,000)
Interest income on FSLIC secondary reserve	(320,000)	(305,000)
Funds provided from operations	19,251,000	18,013,000
Principal payments on real estate loans	51,419,000	35,029,000
Additions to deferred loan fees	79,000	277,000
Sales of real property, net of gains	4,423,000	1,769,000
Increase in notes payable	—	23,270,000
Increase in loans in process	843,000	—
Additions to unrealized profit on real property	489,000	155,000
Increase in savings deposits	10,342,000	—
Decrease in cash	—	1,332,000
Other, net	3,222,000	—
Total funds provided	$ 90,068,000	79,845,000
Funds used:		
Cash dividends declared and paid (note 7)	$ 1,424,000	1,187,000
Decrease in savings deposits	—	27,223,000
Decrease in notes payable	24,765,000	—
Investment in real estate loans	36,317,000	31,998,000
Investment in buildings and other assets	275,000	282,000
Additions to real property	1,626,000	2,219,000
Decrease in loans in process	—	1,883,000
Investment in stock of Federal Home Loan Bank	222,000	54,000
Decrease in advances by borrowers for taxes and insurance	350,000	132,000
Increase in marketable securities	21,970,000	13,037,000
Increase in cash	3,119,000	—
Other, net	—	1,830,000
Total funds used	$ 90,068,000	79,845,000

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements December 31, 1975 and 1974

(1) **Summary of Significant Accounting Policies**

The following items comprise the significant accounting policies which the Company follows:

Principles of Consolidation

The consolidated financial statements include the accounts of Wesco Financial Corporation (the Company) and its wholly owned subsidiary, Mutual Savings and Loan Association and its wholly owned subsidiaries (Mutual Savings). All material intercompany transactions have been eliminated.

Marketable Securities

U.S. Government, agency obligations and other marketable securities are carried at identified cost, adjusted for amortization of premium and accretion of discount over the term of the security and are not carried at the lower of cost or market because it is management's intention to hold them to maturity.

Common and preferred stocks are carried at identified cost. See Note 11 for discussion of marketable equity securities.

Loan Fees

Loan fees for originating loans are deferred for amounts in excess of 1% of the loan amount plus $200 for non-construction loans and 2% of the loan amount plus $200 for construction loans. Deferred fees are amortized into income by use of the straight-line method over seven years.

Loan Valuation Allowances

Valuation allowances for estimated losses on specific loans are charged to earnings when any significant and permanent decline reduces the market value of the underlying security to less than the loan. Such losses are usually indicated during foreclosure proceedings.

Real Property Valuation Allowances

Valuation allowances for estimated losses on real property are charged to earnings when any significant and permanent decline reduces the market value to less than the carrying value.

When the Company intends to hold real estate held for sale for a period in excess of 18 months, future direct holding costs for maintenance, property taxes, insurance, direct selling expenses, costs of completion or improvement and a discount factor to give effect to the cost of money are considered in determining the amount of required valuation allowances.

Office Properties and Equipment

Office properties and equipment are depreciated by use of the straight-line method over the estimated useful lives of the various classes of assets from the respective dates of acquisition. The useful lives used for the principal classes of assets are:

Buildings and improvements	10 to 45 years
Furniture, fixtures and equipment	4 to 10 years
Leasehold improvements	3 to 25 years

Maintenance and repairs are charged to appropriate expense accounts in the year incurred; renewals and material betterments are charged to property accounts.

Cost and accumulated depreciation and amortization applicable to assets retired or otherwise disposed of are eliminated from the related accounts and the profit or loss on disposition is credited or charged to earnings.

Profit on the Sale of Real Property

Profit on the sale of real property is recognized when the buyer has made an irrevocable commitment to the sale and has met certain down payment and amortization requirements. In general, the down payment requirements range from 10% to 25% for improved property and from 15% to 30% for unimproved property based on the use of the property and cash flow projections. Amortization requirements include the payment on an annual level payment basis (principal and interest) over a period not to exceed from 15 to 30 years, depending on the type and use of the property, with payments commencing not later than one year from date of sale.

(2) Loans Receivable

Loans receivable are summarized as follows:

	1975	1974
Real estate loans on residential property of:		
One to four units (home loans)	$273,496,000	284,885,000
More than four units	87,250,000	92,786,000
Real estate loans on other properties	13,265,000	11,496,000
	374,011,000	389,167,000
Less:		
Unearned loan fees	(812,000)	(1,075,000)
Unrealized profit on sales of real property	(1,025,000)	(1,404,000)
Loans in process	(1,133,000)	(290,000)
	371,041,000	386,398,000
Loans on savings deposits	2,018,000	2,667,000
	$373,059,000	389,065,000

(3) Notes Payable

The following is a summary of notes payable:

Federal Home Loan Bank advances, secured by certain real estate loans and Federal Home Loan Bank stock, with interest at 7.50% in 1975 and 7.50% to 9.75% in 1974 and with maturity dates as follows:

Year ending Dec. 31,	1975	1974
1975	$ —	17,400,000
1976	343,000	343,000
1977	3,494,000	3,494,000
1978	3,494,000	3,494,000
1979	3,494,000	3,494,000
1980	3,494,000	3,494,000
1981-1984	11,881,000	11,881,000
	26,200,000	43,600,000
Bank notes due on demand with interest principally at prime secured by certain marketable securities and real estate loans	10,000	7,375,000
	$ 26,210,000	50,975,000

(4) Taxes on Income

If certain conditions are met, savings and loan associations, in determining taxable income, are allowed special bad debt deductions based on specified experience formulas or on a percentage of taxable income before such deduction. The bad debt deduction must be within certain limitations based on outstanding loans and the ratio of reserves and undivided profits to savings deposits. Mutual Savings has reached such limitations which preclude deductions from income in arriving at Federal taxes on income.

The investment tax credit, which is insignificant, is recorded by the flow-through method of accounting whereby, in the year available for utilization, it is applied as a reduction of income tax expense.

Appropriated retained earnings at December 31, 1975 and 1974 include approximately $44,940,000 and $43,852,000, respectively, (before elimination of $810,000 in consolidation) of tax reserves for which no provision for Federal income taxes has been made. If in the future these appropriations are used for any purpose other than to absorb bad debt losses, Federal income taxes will be imposed at the then applicable rates.

Federal income tax returns of the Company and Mutual Savings for 1972 and 1973 are currently under examination by the Internal Revenue Service. In the opinion of management, additional tax assessments, if any, will not have a material effect on the accompanying consolidated financial statements.

Income taxes for 1975 and 1974 include the following components:

	1975		1974	
	Current	Deferred	Current	Deferred
Federal	$2,867,000	(594,000)	2,451,000	—
State	868,000	(64,000)	811,000	—
Total	$3,735,000	(658,000)	3,262,000	—

Deferred taxes result from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences in 1975 and 1974 and the tax effect of each were as follows:

	1975	1974
Financial statement recognition of loan fees less than tax recognition	$ (290,000)	(156,000)
California franchise tax recognized for financial statement purposes on accrual basis, but on cash basis for tax purposes	(128,000)	156,000
FSLIC secondary reserve interest income recognized on the financial statements, but deferred for tax purposes	45,000	166,000
Investment income recognized for financial statement purposes on accrual basis, but on cash basis for tax purposes	(150,000)	(24,000)
Other timing differences	(135,000)	(142,000)
	$ (658,000)	—

A reconciliation of total income tax and the amount computed by applying the U.S. Federal income tax rate of 48% to earnings before taxes on income follows:

	1975	1974
Computed "expected" Federal taxes	$3,565,000	3,451,000
Increases (reductions) in taxes resulting from:		
Net gains on sales of foreclosed real property	(278,000)	(219,000)
State franchise tax, net of Federal income tax benefit	418,000	422,000
Dividends received deduction on common and preferred stocks	(796,000)	(397,000)
Other permanent differences	168,000	5,000
	$3,077,000	3,262,000

(5) Office Properties and Equipment, Net

Office properties and equipment at cost less accumulated depreciation and amortization consist of the following:

	1975	1974
Land	$1,509,000	1,509,000
Office buildings and leasehold improvements	5,989,000	5,780,000
Furniture, fixtures and equipment	919,000	930,000
	8,417,000	8,219,000
Accumulated depreciation and amortization	3,337,000	3,079,000
	$5,080,000	5,140,000

(6) Retirement Plan

A noncontributory retirement plan is in effect for all eligible employees of the Company and its subsidiaries. Employer contributions are computed utilizing the aggregate cost funding method. The contributions for 1975 and 1974 approximated $87,000 and $94,000, respectively. The actuarially computed value of vested benefits as of December 31, 1975 and 1974 did not exceed the market value of the assets of the retirement fund.

The Employee Retirement Income Security Act of 1974 became law on September 2, 1974 and is principally concerned with participation, vesting, and funding requirements. Pension plans in existence on January 1, 1974 are not subject to those requirements until plan years beginning after December 31, 1975. Some changes to the plan will be required and the effect of such changes on future provisions for pension expense, periodic funding of pension costs or unfunded vested benefits will not be known until revised actuarial computations are made.

(7) Dividends

Quarterly cash dividends of $.15 per share declared and paid during 1975 amounted to $1,424,000. Cash dividends declared and paid during 1974 amounted to $1,187,000.

(8) Reserve Requirements

The Federal Savings and Loan Insurance Corporation, in connection with the insurance of savings deposits, requires savings and loan associations to maintain certain reserves which may be used only for the purpose of absorbing losses. In addition, associations must maintain certain reserves under California law. Such reserve requirements were met by Mutual Savings as of December 31, 1975 and 1974.

(9) Real Estate Operations

Operations and net gains from sales of real property are summarized as follows:

	1975	1974
Recognized net gains from sales	$ 920,000	591,000
Income from rentals	151,000	108,000
	1,071,000	699,000
Less maintenance and sales expense	162,000	106,000
	$ 909,000	593,000

(10) Contingent Liabilities

Mutual Savings is named as one of the defendants in several class actions relating to certain common practices in the mortgage lending field. The outcome of this litigation cannot be predicted; however, based on the facts presently available, the Association believes there are substantial defenses to these actions and that losses, if any, would not be material.

In addition, Mutual Savings is a defendant in two actions involving alleged easement rights. Mutual's counsel believes there are meritorious defenses to these actions and there is a substantial chance the cases can be successfully defended. While there is some risk to Mutual, in management's opinion, any such risk would not be material.

(11) Marketable Equity Securities

The investment in marketable equity securities consists of common stocks of $1,853,000 and preferred stocks of $10,500,000, at cost. At December 31, 1975 the difference between cost and market value representing unrealized gains or losses is not material.

Accountants' Report

Peat, Marwick, Mitchell & Co.
Certified Public Accountants
[illegible] South Flower Street
Los Angeles, California [illegible]

The Board of Directors
Wesco Financial Corporation:

We have examined the consolidated balance sheets of Wesco Financial Corporation and subsidiaries as of December 31, 1975 and 1974 and the related consolidated statements of earnings, stockholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Wesco Financial Corporation and subsidiaries at December 31 1975 and 1974 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

Los Angeles, California
January 30, 1976

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Senior Vice President, Savings

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